

EXHIBIT 29

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
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UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
IN SEATTLE

UNITED STATES OF AMERICA,)
Petitioner,) No. CV15-102RSM
v.) No. CV15-103RSM
MICROSOFT CORPORATION,)
et al.,)
Respondents.)

EVIDENTIARY HEARING

August 25, 2015

BEFORE THE HONORABLE RICARDO S. MARTINEZ
UNITED STATES DISTRICT COURT JUDGE

APPEARANCES:

For the Petitioner: James Weaver
Jeremy Hendon
Amy Matchison
U.S. DEPARTMENT OF JUSTICE

For the Respondent: Philip Beck
Brian Prestes
Robert Tannenbaum
Sean Gallagher
BARTLIT BECK HERMAN PALENCHAR &
SCOTT
Patricia Eakes
Andrea Ostrovsky
CALFO HARIGAN LEYH & EAKES

1	EXAMINATION INDEX	
2	EXAMINATION OF	PAGE
3	ELI HOORY	
4	DIRECT EXAMINATION	
5	By Mr. Beck	
6	CROSS-EXAMINATION	
7	By Mr. Weaver	
8		145
9		
10		
11		
12		
13		
14		
15		
16		
17		
18		
19		
20		
21		
22		
23		
24		
25		
7	EXHIBIT INDEX	
8	EXHIBITS ADMITTED	PAGE
9	16	
10	15	
11	41	
12	41	
13	13	
14	28	
15	29	
16	30	
17	23	
18	22	
19	21	
20	1	
21		148
22		158
23		161
24		166
25		176
		177
		178
		179
		189
		189
		190
		193

09:33:49AM 1 THE CLERK: We are here for an evidentiary hearing
09:33:51AM 2 in the matter of the United States versus Microsoft
09:33:54AM 3 Corporation, Case No. C15-102, assigned to this court, and
09:33:59AM 4 United States versus Craig J. Mundie, et al., Case
09:34:05AM 5 No. C15-103, assigned to this court.

09:34:07AM 6 Counsel, please rise and make your appearance for the
09:34:10AM 7 record.

09:34:10AM 8 MR. WEAVER: James Weaver on behalf of the United
09:34:12AM 9 States. With me are Jeremy Hendon and Amy Matchison.

09:34:17AM 10 THE COURT: Good morning.

09:34:19AM 11 MR. BECK: Philip Beck on behalf of Microsoft.

09:34:21AM 12 MS. EAKES: Patty Eakes on behalf of Microsoft.

09:34:24AM 13 MS. OSTROVSKY: Andrea Ostrovsky on behalf of
09:34:28AM 14 Microsoft, your Honor.

09:34:28AM 15 MR. PRESTES: Brian Prestes on behalf of
09:34:30AM 16 Microsoft.

09:34:32AM 17 MR. GALLAGHER: Sean Gallagher on behalf of
09:34:34AM 18 Microsoft.

09:34:35AM 19 MR. TANNENBAUM: Robert Tannenbaum on behalf of
09:34:37AM 20 Microsoft.

09:34:38AM 21 THE COURT: Good morning to all of you. Thank
09:34:40AM 22 you.

09:34:44AM 23 Counsel, we have basically a day for our evidentiary
09:34:50AM 24 hearing that we have scheduled. The court has other
09:34:52AM 25 matters tomorrow, so we need to be able to get it

09:34:55AM 1 concluded today.

09:34:56AM 2 Let me indicate for purposes of a lot of people that
09:35:00AM 3 are in the courtroom, that may not know exactly what the
09:35:03AM 4 purpose of what is going on in this particular hearing, it
09:35:06AM 5 is actually a quite narrow issue. In this matter -- this
09:35:14AM 6 is an enforcement matter brought by the IRS against
09:35:17AM 7 Microsoft. Whenever a taxpayer objects or neglects to
09:35:25AM 8 obey a designated summons, the IRS may bring an
09:35:28AM 9 enforcement action in United States District Court. That
09:35:32AM 10 is what has happened here.

09:35:33AM 11 In order to obtain the court's enforcement, the IRS
09:35:36AM 12 then has the burden of making the initial showing of its
09:35:39AM 13 good faith by establishing that the investigation that it
09:35:43AM 14 is doing, or has done, will be conducted pursuant to a
09:35:47AM 15 legitimate purpose, that the inquiry may be relevant to
09:35:50AM 16 that purpose, that the information sought is not already
09:35:53AM 17 within the possession of the IRS, and that the
09:35:56AM 18 administrative steps required by the Internal Revenue Code
09:35:59AM 19 have been followed. In this case the court has already
09:36:02AM 20 made the finding that the IRS has made that *prima facie*
09:36:06AM 21 showing.

09:36:07AM 22 Once that occurs, once the IRS makes its initial
09:36:10AM 23 showing, then the burden shifts to the taxpayer, in this
09:36:13AM 24 case Microsoft, to demonstrate that enforcement of that
09:36:16AM 25 summons would result in an abuse of the court's process.

09:36:21AM 1 This adversarial enforcement proceeding exists to
09:36:25AM 2 protect against abuse of the power vested in tax
09:36:28AM 3 collectors. At the same time, enforcement proceedings are
09:36:31AM 4 to be summary in nature; the court is to avoid any broader
09:36:37AM 5 role than simply determining whether or not the IRS issued
09:36:40AM 6 a contested summons in good faith and without an improper
09:36:44AM 7 purpose.

09:36:45AM 8 The Supreme Court has held that a taxpayer is entitled
09:36:48AM 9 to a pre-enforcement evidentiary hearing upon making a
09:36:52AM 10 sufficient threshold showing of a defense or possible
09:36:55AM 11 defense for enforcement. This showing requires the
09:36:58AM 12 taxpayer to point to specific facts or circumstances
09:37:02AM 13 plausibly raising an inference of bad faith or of another
09:37:06AM 14 appropriate ground in order to quash the summons. Naked
09:37:11AM 15 allegations of improper purpose are simply not enough.
09:37:14AM 16 The taxpayer must offer some credible evidence supporting
09:37:19AM 17 their charge.

09:37:20AM 18 Use of circumstantial evidence is sufficient to make a
09:37:23AM 19 threshold showing. Discovery is then warranted if the
09:37:27AM 20 taxpayer, through the hearing, can make a substantial
09:37:30AM 21 preliminary showing of abuse, of wrongdoing. That's the
09:37:35AM 22 purpose of what we are here to do today.

09:37:38AM 23 My understanding, from looking at the materials
09:37:39AM 24 submitted by both sides, is that there is one live witness
09:37:44AM 25 apparently that will be called. There may be other

09:37:46AM 1 witnesses, depending on what happens. But I also
09:37:50AM 2 understand that Microsoft is relying on the declarations
09:37:55AM 3 of several other witnesses. The court understands that.

09:37:59AM 4 Are we ready? Since the burden is on Microsoft, I am
09:38:04AM 5 not sure who is going to be starting. Ms. Eakes.

09:38:07AM 6 MR. WEAVER: Your Honor, could I raise one
09:38:08AM 7 preliminary matter?

09:38:09AM 8 THE COURT: Mr. Weaver.

09:38:14AM 9 MR. WEAVER: Microsoft has identified as potential
09:38:17AM 10 witnesses two attorneys, Daniel Rosen and James O'Brien.
09:38:20AM 11 If they are going to possibly call them in rebuttal to our
09:38:22AM 12 witness, Mr. Hoory, we would ask that the court exclude
09:38:27AM 13 and sequester those witnesses.

09:38:34AM 14 MR. BECK: We are not going to be calling them,
09:38:37AM 15 your Honor, especially given our need to finish today.

09:38:40AM 16 THE COURT: All right. Ms. Eakes.

09:38:41AM 17 MS. EAKES: Thank you. Good morning, your Honor.
09:38:44AM 18 As the court has just stated, Microsoft is here today to
09:38:46AM 19 ask the court to order discovery so that there will be a
09:38:49AM 20 complete factual record before the court ultimately
09:38:51AM 21 decides whether enforcing the designated subpoenas or
09:38:54AM 22 summonses would result in an abuse of this court's
09:38:57AM 23 process.

09:38:57AM 24 Now, as the court knows, this case is unusual in that
09:39:01AM 25 it raises a couple of important issues to larger issues of

09:39:04AM 1 tax administration. It raises issues about whether or not
09:39:08AM 2 the IRS can or cannot use outside lawyers to perform audit
09:39:12AM 3 tasks, to take summon testimony, and to examine taxpayer
09:39:17AM 4 books and records, which are tasks that have historically
09:39:19AM 5 been reserved to the province of government officers and
09:39:24AM 6 employees. And it raises issues about whether the
09:39:26AM 7 temporary regulation that the IRS enacted weeks after
09:39:29AM 8 retaining Quinn Emanuel, and that purport to allow
09:39:32AM 9 government lawyers -- the non-government lawyers to take
09:39:35AM 10 summon testimony is valid. Those are the questions that
09:39:38AM 11 the court must ultimately reach.

09:39:40AM 12 But as the court just pointed out, that is not the
09:39:42AM 13 issue today. The issue today is simply whether or not
09:39:45AM 14 Microsoft has made a substantial preliminary showing the
09:39:49AM 15 enforcement of the subpoenas -- or the summonses would
09:39:51AM 16 abuse this court's process. We think we are going to make
09:39:54AM 17 that showing today, and as a result we are going to ask
09:39:56AM 18 the court to order some very limited and targeted
09:39:59AM 19 discovery, with the goal being to create a full record.

09:40:03AM 20 Microsoft is expecting today that we are going to
09:40:06AM 21 present evidence on four different issues: First of all,
09:40:09AM 22 the role that Quinn Emanuel has played in the audit to
09:40:12AM 23 date, the role that Quinn Emanuel will be playing going
09:40:16AM 24 forward in the audit. We are going to present evidence
09:40:19AM 25 that the procedures used by the IRS to enact the temporary

09:40:23AM 1 regulation are inconsistent with recent decision-making
09:40:27AM 2 and the other requirements of the APA. We are going to
09:40:31AM 3 present evidence that raises questions and concerns about
09:40:33AM 4 the administrative record that has been put forward by the
09:40:36AM 5 IRS in this case, and that go to its completeness and its
09:40:41AM 6 accuracy. We think it will require there be additional
09:40:44AM 7 discovery in order to determine what exactly the
09:40:48AM 8 administrative record should be.

09:40:49AM 9 As the court pointed out, we have already made the
09:40:52AM 10 preliminary showing. I am not going to cover what we have
09:40:56AM 11 already presented to the court, because it sounds like the
09:40:58AM 12 court has reviewed that and is aware of where we already
09:41:02AM 13 stand today. So let me talk about what we are going to
09:41:04AM 14 put on today or what we expect to put on today.

09:41:06AM 15 First of all, I want to start with the timeline so the
09:41:12AM 16 court kind of understands the key events. And I do have
09:41:15AM 17 copies of this PowerPoint for the court if you would like
09:41:18AM 18 to have one, a hard copy, or I can provide it to the court
09:41:21AM 19 after we are done.

09:41:23AM 20 First of all, the audit in this case began back in
09:41:27AM 21 January of 2007. It is an audit of the 2004/2006 tax
09:41:31AM 22 years. Now, Microsoft was engaging with the IRS from 2007
09:41:36AM 23 all the way forward into 2014.

09:41:39AM 24 And it appeared that the audit was winding down
09:41:43AM 25 towards the end of 2013. In fact, you will hear that in

09:41:48AM 1 January of 2014 the IRS met with Microsoft and they
09:41:52AM 2 presented their position on the Americas cost-sharing
09:41:55AM 3 arrangement. Now, that date is not on the timeline, but
09:41:58AM 4 you will hear testimony about that.

09:42:00AM 5 Ordinarily after that meeting it would have been the
09:42:03AM 6 end of the audit. And that's what Microsoft anticipated,
09:42:07AM 7 was that the audit was winding up after they received the
09:42:11AM 8 presentation from the IRS. But what Microsoft didn't know
09:42:14AM 9 is that the IRS had an entirely different plan that they
09:42:20AM 10 didn't disclose to Microsoft.

09:42:21AM 11 In fact, we know from the government's timeline that
09:42:24AM 12 starting back in November of 2013 the IRS had engaged with
09:42:30AM 13 Quinn Emanuel, a private outside law firm, with a plan to
09:42:34AM 14 involve them in the audit, and eventually to take the
09:42:37AM 15 underlying tax case to trial.

09:42:39AM 16 They didn't disclose that fact to Microsoft, and in
09:42:42AM 17 fact, through the first half of 2014, the IRS continued to
09:42:47AM 18 engage with Microsoft about the audit, all the while they
09:42:51AM 19 were meeting with Quinn Emanuel. They were having
09:42:53AM 20 settlement talks with Microsoft, but not advising them
09:42:57AM 21 about Quinn Emanuel being in the wings. And they entered
09:43:00AM 22 into a contract with Quinn Emanuel. Again, Microsoft
09:43:03AM 23 didn't know anything about it.

09:43:05AM 24 The IRS also did not disclose that to Microsoft at the
09:43:09AM 25 time in February of 2014, when they asked Microsoft to

09:43:15AM 1 extend the statute of limitations for the audit, which at
09:43:18AM 2 that time was set to expire in June of 2014. So Microsoft
09:43:21AM 3 agreed to that extension, having no knowledge of the fact
09:43:25AM 4 that Quinn Emanuel was being engaged, or had already been,
09:43:29AM 5 or was on the verge of being hired.

09:43:31AM 6 Microsoft also later learned that simultaneously --
09:43:35AM 7 and, again, they didn't know any of this was happening --
09:43:38AM 8 that the IRS was putting together and enacting a temporary
09:43:41AM 9 regulation that they planned to point to to say that Quinn
09:43:45AM 10 Emanuel could examine Microsoft's books and records and
09:43:48AM 11 take summon testimony pursuant to the designated
09:43:51AM 12 summonses.

09:43:52AM 13 It wasn't until late August, and specifically
09:43:57AM 14 August 28th, 2014, that the IRS finally disclosed the fact
09:44:01AM 15 that they had hired Quinn Emanuel, and that they intended
09:44:04AM 16 to have them present at the upcoming interviews of
09:44:07AM 17 Microsoft employees that were scheduled for September of
09:44:09AM 18 that same year.

09:44:11AM 19 Now, even after that disclosure, the IRS continued to
09:44:16AM 20 hide the ball from Microsoft about what exactly was going
09:44:19AM 21 on. When Microsoft got notice about Quinn Emanuel they
09:44:22AM 22 asked the IRS, "Hey, give us a copy of your engagement
09:44:26AM 23 letter." The testimony is going to show that Mr. Hoory
09:44:30AM 24 said, "We don't have an engagement letter with Quinn
09:44:33AM 25 Emanuel." So Microsoft went, did their own research,

09:44:37AM 1 found that in fact on a government database there was a
09:44:40AM 2 contract between Quinn Emanuel and the IRS. So they wrote
09:44:42AM 3 to the IRS and said, "Give us a copy of the contract, if
09:44:45AM 4 you don't call it an engagement letter." The IRS said,
09:44:48AM 5 "Well, okay, there is a contract, and here we are sending
09:44:51AM 6 you the full contract."

09:44:52AM 7 The court is going to hear that in fact the IRS only
09:44:55AM 8 sent a portion of that contract to Microsoft. The portion
09:45:00AM 9 they chose to withhold from Microsoft was the part that
09:45:03AM 10 showed that in fact they had engaged Quinn Emanuel for the
09:45:06AM 11 purpose of eventually litigating the tax case, among other
09:45:10AM 12 things.

09:45:10AM 13 Let me just talk for a moment about the hiring of
09:45:17AM 14 Quinn Emanuel. The court is going to hear that the IRS
09:45:23AM 15 engaged Quinn Emanuel as contractors, not as government
09:45:27AM 16 employees. As contractors, Quinn Emanuel was not bound by
09:45:32AM 17 the conflict and ethics rules that are applicable to
09:45:35AM 18 Treasury Department lawyers. This is a significant issue,
09:45:38AM 19 and it is not one that just Microsoft was concerned about.

09:45:42AM 20 When the Senate Finance Committee realized that the
09:45:46AM 21 IRS had outsourced an audit to private lawyers, Senator
09:45:51AM 22 Orrin Hatch wrote a letter to the IRS. This is a copy of
09:45:54AM 23 the letter on PowerPoint now. He pointed out, "Unlike
09:45:58AM 24 private contractors, Treasury Department officials are
09:46:00AM 25 required to swear an oath to the Constitution and are

09:46:03AM 1 subject to rules of conduct and federal law regulating
09:46:05AM 2 their interactions with taxpayers." He went on to say,
09:46:08AM 3 "This is one of the core reasons Congress has sought to
09:46:10AM 4 limit certain examination actions to these officials, who
09:46:14AM 5 are accountable to the public, and for whom there is a
09:46:17AM 6 clear chain of command." And he expressed concern about
09:46:21AM 7 "turning over inherently governmental functions, such as
09:46:24AM 8 conducting an examination, to private contractors, because
09:46:28AM 9 it doesn't protect the rights of taxpayers."

09:46:33AM 10 Now, the concerns about Quinn Emanuel and using a
09:46:36AM 11 private law firm like Quinn Emanuel in this case, in the
09:46:39AM 12 Microsoft audit, were very real. As the court is going to
09:46:42AM 13 hear, there are a number of conflicts that Quinn Emanuel
09:46:44AM 14 had and that existed at the time the IRS chose to disclose
09:46:48AM 15 confidential taxpayer -- Microsoft's confidential taxpayer
09:46:52AM 16 information to Quinn Emanuel without ever giving Microsoft
09:46:56AM 17 any advance notice to have an opportunity to protect their
09:46:59AM 18 rights.

09:46:59AM 19 The court is going to hear testimony that Quinn
09:47:02AM 20 Emanuel is the primary outside counsel to Google, and that
09:47:05AM 21 Google is one of Microsoft's largest competitors. In
09:47:09AM 22 fact, at the time -- after Microsoft was aware of the
09:47:16AM 23 hiring of Quinn Emanuel they provided to the IRS a list of
09:47:21AM 24 cases that they had actively against Microsoft at that
09:47:25AM 25 time. And there were 34 cases that Quinn Emanuel was

09:47:29AM 1 handling that were directly adverse to Microsoft. And
09:47:34AM 2 they knew that at the time -- or they had these cases at
09:47:37AM 3 the time the IRS was disclosing behind Microsoft's back
09:47:40AM 4 the confidential taxpayer information.

09:47:42AM 5 Now, let me just shift for a minute and tell the court
09:47:48AM 6 what we expect the evidence is going to show with respect
09:47:51AM 7 to Quinn Emanuel and their role that they had been playing
09:47:54AM 8 in this audit. The evidence is going to show that Quinn
09:47:58AM 9 Emanuel told the IRS what records it wanted, and the IRS
09:48:01AM 10 asked Microsoft to produce them. Quinn told the IRS who
09:48:07AM 11 they wanted to question and on what topics, and the IRS
09:48:09AM 12 asked Microsoft to make those employees available. Quinn
09:48:13AM 13 identified who they wanted to have questioned under oath
09:48:15AM 14 pursuant to the designated summonses, and the IRS issued
09:48:18AM 15 those summonses. Quinn was also involved and participated
09:48:24AM 16 in deciding the content of the designated summonses that
09:48:26AM 17 are before this court. We also know that the IRS has said
09:48:32AM 18 definitively that if the court enforces these summonses,
09:48:35AM 19 it intends to have Quinn Emanuel do some of the
09:48:38AM 20 questioning of the Microsoft witnesses.

09:48:41AM 21 And even though the IRS has told this court, "Well,
09:48:46AM 22 Quinn Emanuel isn't engaging in any inherently
09:48:49AM 23 governmental functions," in fact, the contract shows that
09:48:54AM 24 in fact the performance of the work involves exactly what
09:48:58AM 25 the temporary regulation says is an inherently

09:49:03AM 1 governmental functions.

09:49:05AM 2 So the Federal Register -- the provision provides that
09:49:09AM 3 one of the things that is inherently governmental function
09:49:12AM 4 is identifying what information must be produced. And the
09:49:15AM 5 Quinn Emanuel contract shows that is exactly what the IRS
09:49:19AM 6 has asked Quinn Emanuel to do.

09:49:21AM 7 Talking about the temporary regulation now. Microsoft
09:49:30AM 8 expects that the evidence is going to show that the IRS
09:49:33AM 9 enacted the temporary regulation, at least in part,
09:49:36AM 10 because of the Microsoft audit. The Microsoft audit is
09:49:40AM 11 being overseen by what is called the LB&I section of the
09:49:45AM 12 IRS, which is the large business and international group.
09:49:47AM 13 The court is going to see evidence that in fact it was the
09:49:51AM 14 LB&I that was the impetus and who initiated the temporary
09:49:55AM 15 regulation.

09:49:58AM 16 You are also going to hear that Mr. Hoory, who is
09:50:01AM 17 going to testify today, is directly overseeing the
09:50:03AM 18 Microsoft audit, and he was aware of the temporary
09:50:06AM 19 regulation, and he weighed in on the wording of the
09:50:10AM 20 temporary regulation and other issues prior to its
09:50:13AM 21 enactment.

09:50:18AM 22 Also, the IRS, in explaining why they needed this to
09:50:22AM 23 be an emergency publication, cited that it was the running
09:50:24AM 24 of the statute of limitations that was the reason they had
09:50:27AM 25 to push this through without the ordinary notice, and

09:50:30AM 1 comment, and time for publication, which only makes sense
09:50:33AM 2 in the context of a particular case or cases, because the
09:50:36AM 3 statute of limitations are expiring all the time on
09:50:40AM 4 audits.

09:50:40AM 5 And the court will hear testimony that in fact the
09:50:44AM 6 Microsoft statute of limitations, the audit, was set --
09:50:47AM 7 the statute of limitations was set to expire within six
09:50:49AM 8 months of the enactment of this temporary regulation.

09:50:54AM 9 We are also going to present evidence that the
09:50:56AM 10 temporary regulation -- the big push by the IRS to get
09:51:00AM 11 this temporary regulation out began on the exact day that
09:51:05AM 12 Microsoft told the IRS that they were no longer going to
09:51:08AM 13 engage in settlement negotiations. So you can see here --
09:51:13AM 14 this is the declaration of Mr. Bernard, who says that on
09:51:16AM 15 March 27th they advised the IRS they were ceasing all
09:51:19AM 16 settlement discussions. On the same day the people at the
09:51:23AM 17 IRS said we have to get this temporary regulation out by
09:51:26AM 18 June 1.

09:51:27AM 19 You are also going to hear evidence from the
09:51:34AM 20 administrative file, and I believe from Mr. Hoory, that
09:51:36AM 21 the IRS anticipated all along that this temporary
09:51:39AM 22 regulation is going to be used by outside lawyers to
09:51:43AM 23 perform the questioning and to examine books and records.
09:51:48AM 24 As you can see, these are just some examples of the
09:51:53AM 25 documents that are in the administrative file, which the

09:51:56AM 1 court will have, which show that the intent all along was
09:51:59AM 2 to involve private lawyers.

09:52:01AM 3 The court will also hear that the Microsoft audit was
09:52:04AM 4 the only case in which private lawyers had been engaged.
09:52:09AM 5 So you see in the temporary -- you see in the
09:52:12AM 6 administrative file that the IRS is fully anticipating
09:52:14AM 7 having lawyers involved, even though the regulation
09:52:16AM 8 doesn't say that. And yet Microsoft is the only case
09:52:19AM 9 where we are going to have private lawyers involved in an
09:52:21AM 10 audit.

09:52:23AM 11 There is also going to be evidence that we will
09:52:29AM 12 present today to show that the IRS wasn't transparent with
09:52:32AM 13 the internal stakeholders at the IRS, the Department of
09:52:37AM 14 Treasury, and OMB, about how they intended for this
09:52:40AM 15 temporary regulation to be used.

09:52:42AM 16 The administrative record is full of examples about
09:52:45AM 17 how the IRS drafters of this regulation appeared to be
09:52:50AM 18 trying to hide the ball from those people within the
09:52:53AM 19 agency about exactly what they intended, and that they
09:52:55AM 20 intended to bring private lawyers into the Microsoft
09:52:59AM 21 audit. I will only show you two examples of those things
09:53:01AM 22 today, but the file consists of more.

09:53:04AM 23 So the internal communications at the IRS about this
09:53:08AM 24 temporary regulation -- again, it was fully intended to
09:53:12AM 25 have lawyers be involved -- told people within the IRS

09:53:15AM 1 that they were implementing the regulation so that people
09:53:18AM 2 such as outside economists, engineers, or consultants
09:53:22AM 3 could participate in the summons interview. There is not
09:53:26AM 4 one word in the internal documents within the IRS that
09:53:29AM 5 says -- tells people within the agency that they intend to
09:53:33AM 6 use this to have lawyers do the questioning -- outside
09:53:37AM 7 lawyers do the questioning in an audit.

09:53:39AM 8 You are also going to hear that despite the fact that
09:53:43AM 9 there were clear policies within the IRS and the IRM
09:53:47AM 10 manual that require early circulation to internal
09:53:51AM 11 stakeholders of the regulation to give them time for
09:53:54AM 12 consideration of it and to provide feedback, that the
09:53:57AM 13 people behind this regulation only gave five days for
09:54:01AM 14 feedback from the internal people before rushing it into
09:54:05AM 15 publication. That is on top of the fact that they weren't
09:54:08AM 16 explicitly telling people within the IRS that this
09:54:11AM 17 regulation is intended to be used by lawyers, that we
09:54:14AM 18 intend to have lawyers involved in audits.

09:54:17AM 19 The court is also going to hear testimony that the IRS
09:54:21AM 20 wasn't transparent with the public about the true purpose
09:54:24AM 21 of the regulation. Now, the IRS, as the court knows,
09:54:29AM 22 issued this as a temporary regulation, which meant that it
09:54:32AM 23 went into effect immediately, and didn't allow for any
09:54:34AM 24 sort of notice and comment period by the public.

09:54:38AM 25 The IRS has typically let the public know about the

09:54:41AM 1 fact that they intend to pass guidance by putting out what
09:54:44AM 2 is called the business plan. The business plan is a
09:54:46AM 3 public document that says here is everything that we are
09:54:49AM 4 expecting to issue guidance on in the upcoming future.

09:54:54AM 5 This regulation, the 7602 regulation, wasn't on the
09:54:58AM 6 business plan. And in fact, it only appeared on the
09:55:00AM 7 business plan after the court granted this hearing, and
09:55:03AM 8 after Microsoft disclosed in its exhibits, when we thought
09:55:07AM 9 the hearing was happening in July, that there were
09:55:09AM 10 business plans where this regulation was absent. After
09:55:13AM 11 all of that happened, suddenly this regulation that the
09:55:16AM 12 IRS had been considering working on since sometime in 2013
09:55:21AM 13 appeared on the business plan.

09:55:22AM 14 And, finally, the other way that the IRS concealed
09:55:27AM 15 from the public what the true purpose of this regulation
09:55:29AM 16 was, was in the wording itself of the regulation. So what
09:55:34AM 17 was published in the Federal Register, which included the
09:55:37AM 18 published explanation of the regulation itself, refers
09:55:41AM 19 only to contractors throughout the regulation, and never
09:55:46AM 20 once says anything about lawyers, even though that was
09:55:50AM 21 clearly the purpose that the IRS had in mind in passing
09:55:53AM 22 this regulation.

09:55:56AM 23 Now, I want to talk for just a moment about the
09:56:01AM 24 administrative record and the concerns that Microsoft has
09:56:03AM 25 about the administrative record. I just want to briefly

09:56:05AM 1 kind of recap why we are talking about the administrative
09:56:08AM 2 record here today. When the court granted the evidentiary
09:56:11AM 3 hearing, you found that there were factual questions that
09:56:15AM 4 went to the validity of the temporary regulation. And the
09:56:17AM 5 IRS initially said they were going to bring one or even
09:56:21AM 6 more than one witness to testify about why the temporary
09:56:24AM 7 regulation was enacted.

09:56:26AM 8 As you will recall, at that time Microsoft asked the
09:56:29AM 9 court for -- to have the IRS produce Heather Maloy, who
09:56:33AM 10 authorized the temporary regulation, so she could testify
09:56:36AM 11 on the issues that the court had identified. And the
09:56:39AM 12 court deferred that request from Microsoft on the
09:56:41AM 13 representation that the IRS intended to call a witness who
09:56:44AM 14 had knowledge about the temporary regulation and its
09:56:48AM 15 enactment.

09:56:48AM 16 So then following that telephonic hearing the IRS
09:56:52AM 17 disclosed that they intended to call somebody by the name
09:56:55AM 18 of Tom Vidano. The IRS then said they wouldn't call
09:57:00AM 19 Mr. Vidano unless Microsoft would agree up front there
09:57:03AM 20 would be no waiver of any known privileges before we ever
09:57:07AM 21 heard anything about his testimony. And Microsoft simply
09:57:10AM 22 couldn't agree to that. And so the IRS withdrew
09:57:14AM 23 Mr. Vidano.

09:57:16AM 24 Even though Mr. Hoory has some knowledge about this
09:57:18AM 25 temporary regulation, the IRS is now taking the position

09:57:21AM 1 that the court should only look at what they claim to be
09:57:24AM 2 the administrative record in deciding if the regulation
09:57:26AM 3 was valid.

09:57:27AM 4 And even assuming that is correct for the sake of this
09:57:30AM 5 argument, there are a number of things about the
09:57:34AM 6 administrative record that has been put forward by the IRS
09:57:36AM 7 that causes concern about whether it is complete, and how
09:57:40AM 8 it was put together, and whether or not the court should
09:57:42AM 9 give it the presumption of regularity that would
09:57:45AM 10 ordinarily apply.

09:57:46AM 11 So I am just going to cover those quickly, what the
09:57:50AM 12 issues are in the administrative record. First of all,
09:57:52AM 13 the case law is clear that the administrative record is
09:57:55AM 14 supposed to contain only what was considered at the time
09:57:58AM 15 prior to the enactment of the temporary regulation, what
09:58:03AM 16 the agency considered.

09:58:07AM 17 Here, the file contains a number of different
09:58:09AM 18 documents that were clearly printed out sometime after the
09:58:13AM 19 regulation went into effect. So these are just a sample
09:58:18AM 20 of the documents that show -- this was back in July
09:58:22AM 21 of 2015 -- this file was filled with things that were
09:58:23AM 22 printed out at that time.

09:58:27AM 23 Now, initially the IRS, when they first disclosed the
09:58:30AM 24 administrative record, didn't say anything about it. They
09:58:32AM 25 subsequently offered a declaration amending it, and

09:58:35AM 1 saying, "Well, these might have a print date of July 2015,
09:58:38AM 2 but they were considered at the time."

09:58:39AM 3 But the IRS hasn't offered any sort of explanation to
09:58:42AM 4 the court -- there is nothing in the file to show that
09:58:44AM 5 these things were in fact considered by the agency at the
09:58:47AM 6 time. There is simply no way for the court to evaluate
09:58:50AM 7 whether or not that representation is accurate.

09:58:52AM 8 Another concern with the administrative record is that
09:58:56AM 9 it has changed. Initially the administrative record was
09:59:00AM 10 disclosed to Microsoft on July 13th. And in the first
09:59:04AM 11 administrative record that we received it included this
09:59:07AM 12 document, Microsoft Exhibit 135. And this was what
09:59:12AM 13 appeared to be a one-page email related to statistics that
09:59:17AM 14 LB&I was providing to support why the temporary regulation
09:59:20AM 15 was necessary. But then on July 17th, four days later,
09:59:26AM 16 DOJ -- IRS provided an updated administrative record, and
09:59:31AM 17 all of a sudden this one-page document was four pages.
09:59:35AM 18 And there was no explanation.

09:59:36AM 19 And it is concerning, because there was no reason to
09:59:42AM 20 believe that the one-page document was anything more than
09:59:44AM 21 a one-page document. There wasn't a privilege log. There
09:59:46AM 22 weren't any redactions. There was simply no explanation
09:59:50AM 23 other than to think it was a one-page document, that four
09:59:53AM 24 days later morphs into a four-page document, without any
09:59:56AM 25 sort of explanation. I think it raises concerns about

09:59:58AM 1 whether or not there are things that are missing from the
10:00:01AM 2 administrative record when it is produced in that fashion.

10:00:04AM 3 And we do know that there are missing records from the
10:00:08AM 4 administrative record that the IRS put forward. As the
10:00:11AM 5 court may recall, Microsoft has made FOIA requests to the
10:00:16AM 6 IRS related to the temporary regulation. And one of the
10:00:18AM 7 things that we asked for were all documents related to the
10:00:22AM 8 regulatory history of the temporary regulation. Microsoft
10:00:27AM 9 expected that would yield basically the records that would
10:00:29AM 10 later become the administrative record, that were part of
10:00:32AM 11 the administrative record.

10:00:34AM 12 Well, in the FOIA case, in response to that request,
10:00:37AM 13 Microsoft received over 1,400 pages of documents in
10:00:42AM 14 response to that request. But the administrative record
10:00:46AM 15 that was produced by the IRS is only 630 pages. There is
10:00:51AM 16 just no explanation for that discrepancy.

10:00:54AM 17 We can also see from looking at the file itself that
10:00:58AM 18 there are things that are missing. This email, which is
10:01:03AM 19 part of the administrative record that they submitted to
10:01:06AM 20 the court, refers to the fact that there is a
10:01:08AM 21 representative contract that is being considered by the
10:01:10AM 22 drafters of this regulation. Clearly it is something that
10:01:15AM 23 was considered by the agency, and yet the attachment isn't
10:01:19AM 24 in the administrative record.

10:01:21AM 25 Well, we know that it exists, because in the FOIA

10:01:24AM 1 action this is what we received, which is the same email,
10:01:28AM 2 with redactions, and an attachment that is fully redacted
10:01:32AM 3 out. So, again, something missing from the administrative
10:01:35AM 4 record that was clearly considered by the agency.

10:01:38AM 5 But even more importantly, last Friday the IRS
10:01:43AM 6 disclosed this document, which now tells the court that
10:01:48AM 7 the IRS -- the drafters of the regulation considered
10:01:52AM 8 precisely the issue that is before this court, and that is
10:01:56AM 9 whether or not contractors can be treated as IRS employees
10:01:59AM 10 for purposes of 7602.

10:02:02AM 11 Now, we received only this email. We didn't receive
10:02:07AM 12 the memo. But what is concerning, and what should concern
10:02:10AM 13 the court, is that neither this email, nor the memo, are
10:02:14AM 14 part of what has been submitted to you as the purported
10:02:17AM 15 administrative record. So there are a lot of questions
10:02:20AM 16 about what is or isn't in the administrative record, and
10:02:23AM 17 why there is the disconnect between that and the FOIA.

10:02:28AM 18 There is also redaction issues that we think should
10:02:31AM 19 concern the court. I am just giving you one example of
10:02:35AM 20 that here. In the summons enforcement case we received
10:02:39AM 21 this document. That's the executive summary for the
10:02:41AM 22 summons interview regulation. And yet in the FOIA case,
10:02:45AM 23 we received it completely redacted on the claim of
10:02:50AM 24 deliberative process.

10:02:54AM 25 Again, this just raises an issue, we think, about

10:02:55AM 1 whether there have been improper redactions for those
10:02:57AM 2 things that are actually in the administrative record, and
10:03:00AM 3 whether or not there are wholesale redactions that have
10:03:04AM 4 been done by the IRS, which is information of --
10:03:08AM 5 information that isn't properly privileged or should be
10:03:10AM 6 considered by this court.

10:03:11AM 7 So that's kind of a quick recap of what we expect the
10:03:17AM 8 evidence is going to show today. I want to take a minute,
10:03:21AM 9 though, and talk about what is not at issue in this
10:03:23AM 10 hearing today. Microsoft fully expects that the IRS is
10:03:28AM 11 going to try to use this evidentiary hearing to try to
10:03:31AM 12 embarrass Microsoft, to portray the company as a tax
10:03:36AM 13 evader, and to improperly disclose our confidential
10:03:40AM 14 taxpayer information, information that would be
10:03:43AM 15 confidential in an audit, and, but for this hearing, would
10:03:46AM 16 not be disclosable to the public.

10:03:48AM 17 Now, the reason we are concerned is not only because
10:03:51AM 18 of the exhibits that have been identified by the IRS for
10:03:53AM 19 this hearing, which go to the underlying financials and
10:03:57AM 20 the issues that are within the audit, but the IRS has also
10:04:03AM 21 publicly stated they plan to basically punish taxpayers
10:04:06AM 22 who fight summons enforcement proceedings.

10:04:10AM 23 You will see in an article to the press -- this is in
10:04:14AM 24 January of 2015, so after Microsoft had let it be known
10:04:18AM 25 that the company intended to fight the summons enforcement

10:04:21AM 1 proceedings, a senior IRS lawyer told the press, "The
10:04:26AM 2 taxpayers and practitioners should be cautious when asking
10:04:29AM 3 for an evidentiary hearing to prove that a summons was
10:04:31AM 4 issued for an improper purpose." They warned that, "An
10:04:36AM 5 evidentiary hearing is a two-way street. It is not simply
10:04:38AM 6 the taxpayer's opportunity to question the agent." And,
10:04:43AM 7 "The taxpayer should think about whether they want to have
10:04:45AM 8 their officials being examined by the IRS in a public
10:04:48AM 9 courtroom, and whether they want to have a DOJ lawyer
10:04:51AM 10 talking about the underlying tax transactions that the IRS
10:04:54AM 11 is looking at."

10:04:56AM 12 That threat is exactly what Microsoft is concerned is
10:05:01AM 13 going to be attempted to be carried out today. We believe
10:05:04AM 14 the IRS is trying to punish Microsoft for successfully
10:05:07AM 15 getting this hearing by disclosing our confidential
10:05:11AM 16 taxpayer information, and sending a message to other
10:05:13AM 17 taxpayers not to do what Microsoft has done and gotten in
10:05:17AM 18 this case. I would urge the court not to permit the IRS
10:05:20AM 19 to do that. The financial information underlying the
10:05:22AM 20 audit, the positions that the parties have taken is simply
10:05:27AM 21 not relevant to any of the issues before the court today.

10:05:30AM 22 It is fundamentally unfair for the IRS to throw out
10:05:35AM 23 numbers, particularly when they are maintaining they
10:05:38AM 24 haven't actually made a conclusion as to what tax is due,
10:05:42AM 25 in a context where Microsoft can't call experts or dispute

10:05:46AM 1 or explain the numbers that are being thrown out and can
10:05:49AM 2 be misconstrued by people.

10:05:51AM 3 In short, we urge the court not to let the IRS misuse
10:05:55AM 4 this hearing, which is supposed to be about the IRS's
10:05:58AM 5 conduct, to publicize Microsoft's confidential
10:06:02AM 6 information.

10:06:05AM 7 In conclusion, Microsoft believes at the end of today
10:06:09AM 8 that we will show the court that there are troubling
10:06:11AM 9 questions here about the IRS's hiring of Quinn Emanuel and
10:06:15AM 10 their involvement in the Microsoft audit.

10:06:19AM 11 Microsoft, of course, has concerns about what the IRS
10:06:22AM 12 has done, but their concerns are also shared by Congress.
10:06:27AM 13 Both the House Ways and Means Committee, as well as the
10:06:31AM 14 Senate Finance Committee, share the concerns that
10:06:33AM 15 Microsoft has. We believe at the end of the presentation
10:06:35AM 16 today the court, too, will have even more questions and
10:06:39AM 17 concerns about what the IRS has done. At that time we
10:06:43AM 18 will ask the court to order some limited discovery so a
10:06:46AM 19 full record can be created before the court decides
10:06:50AM 20 whether or not to enforcement the summonses. Thank you.

10:06:54AM 21 THE COURT: Ms. Eakes, thank you very much.

10:06:57AM 22 Mr. Weaver, I don't know if you, the IRS, would like
10:07:00AM 23 to make any preliminary statements before we call the
10:07:02AM 24 first witness, or should we just get into the first
10:07:06AM 25 witness?

10:07:07AM 1 MR. WEAVER: Yes, your Honor, if we could.

10:07:27AM 2 Your Honor, the story of how Microsoft -- excuse me,

10:07:31AM 3 the story of how the IRS came to retain Quinn Emanuel

10:07:34AM 4 begins in 2011. In June of that year Microsoft submitted

10:07:38AM 5 to the IRS a document called a protest. In that protest

10:07:43AM 6 Microsoft took issue with certain adjustments that the IRS

10:07:46AM 7 had proposed making to Microsoft's tax returns for the

10:07:52AM 8 2004 through 2006 years, adjustments that would increase

10:07:55AM 9 Microsoft's taxable income by billions of dollars.

10:07:58AM 10 Now, those adjustments arise from two complex

10:08:01AM 11 international arrangements that we will call today the

10:08:05AM 12 Americas transaction and the Asia Pacific transaction.

10:08:09AM 13 In its protest Microsoft claimed that the analysis

10:08:13AM 14 underlying the IRS's notice of proposed adjustments was,

10:08:17AM 15 quote, arbitrary and capricious. And Microsoft argued

10:08:21AM 16 that the valuation method used by the IRS to figure out

10:08:25AM 17 and measure the income from these transactions was

10:08:28AM 18 improper. They complained that the IRS should have used a

10:08:32AM 19 different method, and taken a more granular look at the

10:08:36AM 20 transactions.

10:08:38AM 21 In support of its protest Microsoft relied heavily on

10:08:42AM 22 a tax court case called Veritas v. Commissioner, a 2009

10:08:47AM 23 case that did not turn out well for the IRS. In Veritas

10:08:51AM 24 the tax court found that expert testimony offered by the

10:08:54AM 25 IRS was unsupported and unreliable. The tax court

10:09:00AM 1 determined that the IRS notice of deficiency, the document
10:09:03AM 2 issued at the conclusion of an audit, was, quote,
10:09:07AM 3 arbitrary and capricious, because the analysis presented
10:09:10AM 4 at trial in Veritas was different than the analysis in the
10:09:16AM 5 exam phase of the case.

10:09:17AM 6 Now, Microsoft's protest is a long document. You will
10:09:21AM 7 see parts of that document today. The protest even
10:09:24AM 8 faulted the IRS for relying on, among other things, notes
10:09:28AM 9 of earlier interviews, interviews not under oath, and not
10:09:32AM 10 transcribed. Microsoft characterized such evidence as,
10:09:36AM 11 quote, of questionable utility.

10:09:39AM 12 Now, starting in late 2011, a relatively new component
10:09:43AM 13 of the IRS called Transfer Pricing Operations, or TPO for
10:09:48AM 14 short, began to coordinate aspects of the Microsoft audit
10:09:53AM 15 that we care about here today.

10:09:55AM 16 And there were several goals in mind for the audit:
10:09:59AM 17 One was to develop facts better; two was to resolve or
10:10:04AM 18 narrow differences, where possible; and three was to make
10:10:07AM 19 greater use of experts of various kinds.

10:10:10AM 20 Now, TPO withdrew the IRS notice of proposed
10:10:14AM 21 adjustment that had generated the protest; and TPO decided
10:10:19AM 22 to take a closer look at the transactions; and of
10:10:24AM 23 particular interest here, the method that Microsoft and
10:10:27AM 24 its advisor KPMG had used to value components of the
10:10:33AM 25 Americas transaction.

10:10:34AM 1 Mr. Hoory, who is here today, a senior advisor with
10:10:38AM 2 TPO, will testify about his understanding that as of July
10:10:42AM 3 2005, Microsoft effectively transferred certain rights and
10:10:46AM 4 software code, such as Windows, to an offshore affiliate
10:10:51AM 5 in Puerto Rico with respect to retail sales in America.
10:10:54AM 6 But Microsoft did not transfer other things, like the
10:10:58AM 7 right to use Microsoft's name, things that you need to
10:11:01AM 8 actually sell product, to the Puerto Rico affiliate. And
10:11:07AM 9 Microsoft's U.S. affiliates would still be doing the
10:11:10AM 10 selling.

10:11:11AM 11 Now, to better understand the KPMG valuation that
10:11:16AM 12 Microsoft was relying on and the assumptions, TPO engaged
10:11:21AM 13 experts in 2012, in software code, brand and marketing
10:11:27AM 14 valuation, as well as financial and industry experts. To
10:11:30AM 15 help pull these disparate areas together, and to develop a
10:11:35AM 16 persuasive and coherent framework, TPO decided to try
10:11:39AM 17 something new, obtaining the services of a commercial
10:11:42AM 18 litigator.

10:11:44AM 19 Mr. Hoory, and his boss, Mr. Maruca, reasoned that the
10:11:49AM 20 ultimate goals of the audit, getting to the right numbers
10:11:52AM 21 and supporting those numbers with solid factual and legal
10:11:54AM 22 support, would be well advanced by obtaining the advice
10:11:59AM 23 and assistance of someone with experience in developing
10:12:02AM 24 and evaluating large complex cases. And TPO reasoned that
10:12:07AM 25 a commercial litigator would also serve as a sounding

10:12:10AM 1 board to provide an independent analysis of the strengths
10:12:14AM 2 and the weaknesses of the audit.

10:12:18AM 3 And make no mistake, Microsoft's audit that we are
10:12:21AM 4 here today about is one of the largest and most
10:12:24AM 5 complicated audits ever undertaken by the IRS.

10:12:28AM 6 To be clear, if the case did not resolve at the exam
10:12:35AM 7 stage, and it went beyond that, then these attorneys might
10:12:38AM 8 also bring experience to the table were a trial to ensue.

10:12:44AM 9 Now, you will learn today that during the second half
10:12:48AM 10 of 2012, TPO first reached out to another law firm, the
10:12:52AM 11 law firm of Boies Schiller. Mr. Hoory hoped to obtain an
10:12:59AM 12 evaluation of the audit, of the strengths and weaknesses,
10:13:03AM 13 from the law firm before making a presentation to
10:13:05AM 14 Microsoft to try and resolve and narrow their differences.
10:13:10AM 15 Unfortunately, nothing was ever done on that contract
10:13:15AM 16 because of conflicts of interest.

10:13:18AM 17 Mr. Hoory first contacted a representative from Quinn
10:13:25AM 18 Emanuel in late 2013.

10:13:28AM 19 Now, to address one of the concerns in your Honor's
10:13:30AM 20 order, Mr. Hoory made no mention of Microsoft before a
10:13:36AM 21 proper nondisclosure agreement was in place.

10:13:39AM 22 The first meeting with Quinn Emanuel took place in
10:13:42AM 23 late February 2014. And the purpose of that meeting was
10:13:45AM 24 to ascertain if the firm would be a good fit for the
10:13:48AM 25 anticipated tasks at hand, the provision of legal advice

10:13:54AM 1 regarding the strengths and weaknesses of the case, and
10:13:57AM 2 assistance in developing facts and legal theories during
10:14:00AM 3 the remainder of the exam.

10:14:03AM 4 After that initial meeting in February, the next
10:14:07AM 5 substantive communications between Mr. Hoory and Quinn
10:14:10AM 6 Emanuel did not occur until July 15, 2014.

10:14:16AM 7 Now, during the intervening months between February
10:14:19AM 8 and July, for reasons having nothing to do at all with
10:14:23AM 9 Quinn Emanuel, resolution discussions with Microsoft,
10:14:27AM 10 discussions that Mr. Hoory had tried to get started
10:14:30AM 11 through a presentation in January of 2014, came to a halt.

10:14:36AM 12 Contrary to allegations, Mr. Hoory will confirm that
10:14:39AM 13 he received no input whatsoever from Quinn Emanuel
10:14:43AM 14 regarding the information document requests, the IDRs,
10:14:48AM 15 served on Microsoft in July of 2014.

10:14:53AM 16 And you will learn from Mr. Hoory, far from
10:14:55AM 17 outsourcing the audit, as has been suggested by Microsoft,
10:14:58AM 18 the direction of the audit, the subject matter of the
10:15:02AM 19 IDRs, the subject matters of the interviews that occurred
10:15:05AM 20 in the fall of 2014, and even the necessary follow-up in
10:15:09AM 21 the summonses that are pending here, these lines of
10:15:13AM 22 inquiry and the subject matters addressed were largely
10:15:17AM 23 determined before Quinn Emanuel read a single audit
10:15:21AM 24 document and provided any advice.

10:15:23AM 25 Now, what has become increasingly clear to Mr. Hoory

10:15:27AM 1 is that some of the assumptions underlying the KPMG
10:15:33AM 2 valuation study relied on by Microsoft are highly
10:15:35AM 3 questionable. And I will get to that in a minute.
10:15:38AM 4 But what about allegations that Quinn Emanuel
10:15:40AM 5 attorneys performed inherently governmental functions?
10:15:45AM 6 Not so, your Honor. We will look today at Quinn Emanuel's
10:15:47AM 7 contract, and we will look at the prohibition in that
10:15:49AM 8 contract against performing inherently governmental
10:15:53AM 9 functions. That section of the contract refers to an OPM
10:15:56AM 10 policy letter that sets out what is and what is not
10:16:00AM 11 inherently governmental. Fact gathering is not inherently
10:16:04AM 12 governmental. Providing legal advice is not inherently --
10:16:10AM 13 an inherently governmental function.
10:16:13AM 14 Now, appearing before a tribunal is an inherently
10:16:17AM 15 governmental function, but Quinn Emanuel did not do that.
10:16:21AM 16 Well, what about inspecting books and records or
10:16:24AM 17 asking questions, two concerns raised in your Honor's
10:16:28AM 18 order? If we could put up the one slide I want to use
10:16:34AM 19 here, which is this slide here. I have put up Section A
10:16:37AM 20 of the summons statute, your Honor, 7602. And what you
10:16:42AM 21 will see -- I have highlighted -- the highlights are
10:16:45AM 22 mine, the words "authority to summon." And then down
10:16:49AM 23 below you will see "secretary is authorized."
10:16:51AM 24 Now, what this statute is doing, your Honor, is
10:16:54AM 25 cloaking the secretary with authority to do the things

10:16:57AM 1 listed below, to examine books and records, to summon
10:17:02AM 2 someone to appear before the IRS, to take testimony. The
10:17:09AM 3 secretary can demand that that occur. But no one -- no
10:17:11AM 4 one except Microsoft, in its briefing, construes Part
10:17:14AM 5 (a) (1) of this statute here as prohibiting an outside
10:17:20AM 6 expert, properly retained under 6103(n), from assisting
10:17:25AM 7 the IRS in review of books and records. In fact, it is
10:17:28AM 8 the necessary practice of the IRS to ask outside experts,
10:17:32AM 9 be they financial, economic, scientific, technical, or
10:17:36AM 10 even sometimes legal experts, to review taxpayer books and
10:17:41AM 11 records.

10:17:42AM 12 Were you to bar experts, under contract properly, from
10:17:49AM 13 looking at books and records obtained through summonses,
10:17:51AM 14 you would effectively shut down virtually all complex
10:17:55AM 15 audits in the IRS. That certainly can't be the proper way
10:17:58AM 16 to interpret the statute.

10:17:59AM 17 Now, your Honor, if the phrase "examine books and
10:18:03AM 18 records" is about who is cloaked with the authority to
10:18:06AM 19 invoke these three things, but is silent on the procedure,
10:18:10AM 20 so too then the phrase in Part 3, "to take such
10:18:14AM 21 testimony," is about who has the authority to require the
10:18:18AM 22 interview, not the procedures of where, or how, or who may
10:18:23AM 23 attend, or even who may speak.

10:18:26AM 24 What about the regulation? You will hear today that
10:18:32AM 25 the regulation -- the temporary regulation allowing

10:18:35AM 1 contractors to fully participate in interviews, which
10:18:40AM 2 Microsoft claims was rushed through hastily for the Quinn
10:18:45AM 3 Emanuel contract, actually arose out of earlier concerns
10:18:48AM 4 in 2013 related to another audit.

10:18:52AM 5 Now, once in the pipeline, of course TPO wanted to get
10:18:56AM 6 the regulation up and running as soon as possible. TPO
10:19:00AM 7 had been using experts to attend interviews and advise the
10:19:04AM 8 IRS, and, where appropriate, interpose questions. But
10:19:08AM 9 there is no improper motive for this regulation. It
10:19:11AM 10 didn't even start with Microsoft.

10:19:15AM 11 What about the summonses? The summonses -- the
10:19:20AM 12 summons requests here flow from Microsoft's failure to
10:19:23AM 13 adequately respond to earlier IRS requests. Only in late
10:19:29AM 14 2014 and 2015, after the summonses were issued, has the
10:19:36AM 15 IRS received details from Microsoft about certain
10:19:39AM 16 financial projections that it has been asking for for some
10:19:42AM 17 time, some of which Microsoft's tax department had
10:19:45AM 18 previously stated either didn't exist or couldn't be
10:19:47AM 19 found.

10:19:48AM 20 It is only after the summonses were issued, your
10:19:51AM 21 Honor, in 2014, that it has become increasingly clear just
10:19:56AM 22 how involved KPMG was, not in just valuing the Americas
10:20:02AM 23 transaction, but in helping Microsoft engineer a
10:20:06AM 24 tax-driven result. Mr. Hoory now has concerns about the
10:20:09AM 25 independence of KPMG's analysis.

10:20:13AM 1 You will see, we will present evidence today, where
10:20:15AM 2 internal KPMG documents call into question the very
10:20:19AM 3 assumptions they are using in the KPMG valuation of the
10:20:23AM 4 Americas transaction. In fact, you will see some meeting
10:20:26AM 5 notes where KPMG is concerned that the affiliate in
10:20:29AM 6 Puerto Rico I referred to earlier would not be operational
10:20:32AM 7 for 18 months after this transaction went into effect.
10:20:35AM 8 Someone writes, quote, "What can we do to make this thing
10:20:38AM 9 real?"

10:20:40AM 10 Now, your Honor, that is important, because if the IRS
10:20:45AM 11 has the legitimate purpose and has issued the summonses at
10:20:49AM 12 issue in good faith, then, unless Microsoft can show --
10:20:54AM 13 make a substantial showing of bad faith or wrongdoing with
10:20:58AM 14 respect to the summonses -- not with respect to some
10:21:01AM 15 flawed policy, but with respect to the summonses, then
10:21:04AM 16 Microsoft is simply not entitled to discovery in this
10:21:07AM 17 summons proceeding.

10:21:10AM 18 And, moreover, questions about the role of Quinn
10:21:13AM 19 Emanuel and the timing and the validity of the regulation
10:21:16AM 20 shrink and become secondary. And why is that? Because
10:21:20AM 21 they only become relevant about who your Honor may allow
10:21:23AM 22 to attend or to speak at an interview. But they don't go
10:21:28AM 23 to whether the interviews should themselves go forward.

10:21:32AM 24 Now, your Honor, let me just address quickly a couple
10:21:35AM 25 of points that Ms. Eakes made. It is true that we had

10:21:38AM 1 hoped in our telephone motions hearing, on the telephone a
10:21:42AM 2 few weeks ago, to produce a live witness to talk about the
10:21:47AM 3 interaction between the Microsoft audit and the
10:21:50AM 4 administrative record, essentially the temporary
10:21:53AM 5 regulation.

10:21:54AM 6 We had someone on our witness list, Mr. Vidano, but he
10:21:59AM 7 is an attorney. So we said, "Okay, we will produce him,
10:22:02AM 8 but he is an attorney -- an LB&I attorney. We want you to
10:22:06AM 9 agree, Microsoft, that we will not have a subject matter
10:22:09AM 10 waiver." That was the proposal. And Microsoft turned
10:22:12AM 11 that down.

10:22:13AM 12 So what we have done is, we have submitted the
10:22:16AM 13 administrative record here today, which is clearly put
10:22:20AM 14 together as best we can. I will address and point the
10:22:23AM 15 court to various parts of that self-authenticating record
10:22:28AM 16 later today.

10:22:31AM 17 Might I add, it is not typical to have a privilege log
10:22:33AM 18 with the submission of an administrative record.

10:22:36AM 19 And what is missing from the administrative record,
10:22:38AM 20 your Honor? Deliberative communications. Deliberative
10:22:44AM 21 communications are not supposed to be part of the
10:22:46AM 22 administrative record.

10:22:47AM 23 Ms. Eakes referred to a memo from A.M. Gulas, one of
10:22:53AM 24 the drafters of the regulation. That is a deliberative
10:22:56AM 25 and privileged document. So, of course, it is not in an

10:22:59AM 1 administrative record.

10:23:03AM 2 Your Honor, by the end of today we are confident that
10:23:06AM 3 your concerns, the ones expressed in your order, will be
10:23:09AM 4 alleviated, and it will be clear why the IRS legitimately
10:23:13AM 5 needs the additional information it seeks to complete this
10:23:16AM 6 audit. Thank you.

10:23:20AM 7 THE COURT: Thank you, Mr. Weaver. Are we ready
10:23:24AM 8 for our first witness then?

10:23:28AM 9 MR. BECK: Yes, your Honor.

10:23:29AM 10 THE COURT: Mr. Beck, you may call your first
10:23:31AM 11 witness.

10:23:32AM 12 MR. BECK: Microsoft calls Mr. Hoory.

10:23:36AM 13 THE COURT: Mr. Hoory, good morning. If I could
10:23:39AM 14 have you make your way around counsel table, come up in
10:23:43AM 15 front of the clerk, raise your right hand and be sworn
10:23:50AM 16 prior to taking the stand.

17 ELI HOORY

10:24:20AM 18 Having been sworn under oath, testified as follows:

10:24:20AM 19 THE CLERK: Could you please state your name for
10:24:22AM 20 the record and spell your last name?

10:24:23AM 21 THE WITNESS: Eli Hoory. The last name is spelled
10:24:27AM 22 H-O-O-R-Y.

10:24:29AM 23 THE COURT: Mr. Hoory, what I need from you is to
10:24:31AM 24 answer the questions in a voice loud enough so everybody
10:24:33AM 25 can hear you. That microphone in front of you amplifies

10:24:38AM 1 only a little bit, but there is a cone, and if you get too
10:24:42AM 2 close, you will get feedback. Keep your voice up. If you
10:24:45AM 3 don't understand the question, simply say so, and we will
10:24:47AM 4 get counsel to rephrase it for you. All right?

10:24:50AM 5 THE WITNESS: Um-hum.

10:24:51AM 6 THE COURT: You may inquire.

10:24:54AM 7 MR. BECK: Thank you, your Honor.

10:24:55AM 8 DIRECT EXAMINATION

10:24:56AM 9 By Mr. Beck:

10:24:57AM 10 Q. Mr. Hoory, I would like to start with a discussion
10:24:59AM 11 about the underlying dispute concerning Microsoft's tax
10:25:03AM 12 liability for the years 2004 through 2006. And I hope we
10:25:08AM 13 can keep it at a fairly general level, simply so the court
10:25:13AM 14 can understand the context in which today's dispute
10:25:17AM 15 arises.

10:25:17AM 16 Does the question that you and Microsoft have been
10:25:27AM 17 struggling over in the underlying audit concern how to
10:25:34AM 18 value intangibles that have been transferred by a U.S.
10:25:39AM 19 company to a foreign affiliate?

10:25:43AM 20 A. That is part of it. It is how to do that, as well as
10:25:46AM 21 how to measure relative values between buckets of
10:25:50AM 22 intangibles. So for that purpose we are actually using
10:25:54AM 23 the same valuation methodology.

10:25:56AM 24 Q. I am not asking you yet about the methodology. One
10:25:59AM 25 of the core issues is, as we have heard from Mr. Weaver,

10:26:03AM 1 there was intangible property, intellectual property, for
10:26:12AM 2 example, that was transferred from U.S. Microsoft to a
10:26:16AM 3 foreign subsidiary or affiliate. And one of the questions
10:26:21AM 4 at least is how to put a proper value on the property that
10:26:25AM 5 was transferred, correct?

10:26:27AM 6 A. That's one. There is also one other geography, the
10:26:31AM 7 Asia Pacific. They are similar issues.

10:26:33AM 8 Q. Now, you agree, don't you, that there is nothing
10:26:38AM 9 inherently improper in a U.S. company transferring
10:26:44AM 10 intangibles or intellectual property to a foreign
10:26:47AM 11 affiliate?

10:26:48AM 12 A. As long as they pay the arm's length price, that is,
10:26:51AM 13 the price that we pay in the market, then it is allowed.

10:26:54AM 14 Q. So the question is, have they paid -- did the foreign
10:26:58AM 15 affiliate pay an arm's length transaction-type price for
10:27:02AM 16 the property that was transferred, right?

10:27:05AM 17 A. That is part of it. Remember, in this case you have
10:27:08AM 18 the foreign affiliate doing a roundtrip. They buy the
10:27:11AM 19 intangible property from the United States, and they
10:27:14AM 20 immediately sell it right back to the U.S. affiliates,
10:27:16AM 21 which then have third-party relationships. So you have
10:27:19AM 22 two prices here, one going out, and then a roundtrip
10:27:22AM 23 coming back into the U.S.

10:27:23AM 24 Q. And neither of the transfers is inherently improper,
10:27:27AM 25 it is just a question of how to place the proper value on

10:27:30AM 1 the thing that was transferred, right?

10:27:32AM 2 A. That is true, unless we look beyond at economic

10:27:34AM 3 substance. So there are provisions that would let us

10:27:37AM 4 disregard the transaction. In this structure, though,

10:27:39AM 5 thus far, we have been focusing on what is the right price

10:27:42AM 6 if we actually respect the transaction as is.

10:27:44AM 7 Q. You say you respect the transaction. And you have

10:27:47AM 8 made no claim whatsoever at any time that this was some

10:27:51AM 9 sort of sham transaction that should be disregarded,

10:27:54AM 10 correct?

10:27:56AM 11 MR. WEAVER: Objection. Mischaracterizes his

10:27:58AM 12 testimony.

10:28:02AM 13 THE COURT: Overruled. Do you understand the

10:28:04AM 14 question?

10:28:06AM 15 THE WITNESS: If counsel could repeat it, I would

10:28:09AM 16 appreciate it.

10:28:10AM 17 THE COURT: Could I have you rephrase, counsel?

10:28:14AM 18 MR. BECK: Sure.

10:28:14AM 19 By Mr. Beck:

10:28:15AM 20 Q. I think you said thus far you respected the

10:28:17AM 21 transaction, right?

10:28:18AM 22 A. I said thus far in our valuation we have tried to

10:28:22AM 23 value it as if the transaction was respected. So you can

10:28:25AM 24 have alternative positions, as you might know. We have

10:28:28AM 25 said, "Okay, what if this is a real deal? What if there

10:28:31AM 1 **is actually substance here? What would the value be**
10:28:33AM 2 **between arm's length parties if you respected it?" And we**
10:28:37AM 3 **basically started with that premise to try to engage in**
10:28:39AM 4 **productive resolution discussions with the company.**

10:28:41AM 5 **Q. Now, this audit has been going on since 2007, right?**

10:28:46AM 6 **A. I believe so.**

10:28:46AM 7 **Q. We are now in 2015. My question, sir, before you**
10:28:53AM 8 **volunteered this on the stand this morning, had anybody**
10:28:58AM 9 **from the IRS ever communicated to Microsoft any concern at**
10:29:03AM 10 **all that these transactions were anything other than**
10:29:07AM 11 **legitimate, and that the question is simply one of valuing**
10:29:11AM 12 **the thing that was transferred?**

10:29:13AM 13 **A. Well, if you look at my January 14 presentation I**
10:29:15AM 14 **gave the company, there is a number of simplifying**
10:29:18AM 15 **assumptions in there. One of those assumptions is, notwithstanding**
10:29:21AM 16 **what we saw as a very little risk in the**
10:29:24AM 17 **Puerto Rican affiliate, we were going to treat it for**
10:29:28AM 18 **purposes of the resolution assumptions in that preliminary**
10:29:30AM 19 **analysis as if they actually were the owner of all, I**
10:29:35AM 20 **guess, features or rights inherent in the technology that**
10:29:38AM 21 **they purchased. So that was a simplifying assumption when**
10:29:41AM 22 **we presented to the company.**

10:29:42AM 23 **Q. Well, what you call now a simplifying assumption, is**
10:29:46AM 24 **you say, "We are proceeding on the basis that these are**
10:29:50AM 25 **legitimate transactions, and the only question is how to**

10:29:52AM 1 value the thing that was transferred," right?

10:29:54AM 2 MR. WEAVER: Objection. Mischaracterizes his last
10:29:57AM 3 answer.

10:29:57AM 4 MR. BECK: He just was saying yes, your Honor.

10:30:00AM 5 THE COURT: Overruled.

10:30:02AM 6 THE WITNESS: Should I answer?

10:30:04AM 7 THE COURT: Yes.

10:30:05AM 8 THE WITNESS: Thank you, your Honor. I was
10:30:06AM 9 pointing out that it actually refers to simplifying
10:30:09AM 10 assumptions in the January 14th meeting. This is not the
10:30:14AM 11 first time I referred to them.

10:30:15AM 12 Mr. Beck:

10:30:15AM 13 Q. What you call the simplifying assumptions was, "We
10:30:19AM 14 are treating these transactions as perfectly legit, it is
10:30:24AM 15 how we put a value on the thing transferred," right?

10:30:26AM 16 A. We were treating them as qualified cost-sharing
10:30:29AM 17 arrangements for purposes of trying to value them. If we
10:30:32AM 18 had not treated them or looked beyond them at the
10:30:34AM 19 substance of the transaction and treated them as not
10:30:37AM 20 qualified cost-sharing arrangements, on that particular
10:30:39AM 21 point, if we have that premise, I was pointing out the way
10:30:42AM 22 the regs work is we don't have to respect the transfer of
10:30:47AM 23 the intangibles. You asked me if we had to respect it,
10:30:50AM 24 and that that was the only possible issue. I was just
10:30:51AM 25 pointing out that it was a simplifying assumption in our

1 presentation that we were respecting the transaction as
10:31:10AM 2 is, notwithstanding -- I was pointing out that it was a
10:31:12AM 3 simplifying assumption in our January 14th meeting. I
10:31:15AM 4 understood your earlier question to ask me if this was
10:31:19AM 5 permitted. The answer is, that is offshore transfers of
10:31:25AM 6 intangibles. That's what I understood you to ask. I was
10:31:29AM 7 pointing out it is permitted. We allow it under qualified
10:31:33AM 8 cost-sharing arrangements. And as a simplifying
10:31:35AM 9 assumption, when we did our valuation, our preliminary
10:31:38AM 10 assessment, which was not complete, it was not final, it
10:31:41AM 11 was supposed to be the starting point of resolution
10:31:44AM 12 discussions with the company, we made a simplifying
10:31:45AM 13 assumption that we were going to respect it as a qualified
10:31:49AM 14 cost-sharing arrangement.

10:31:49AM 15 Q. Well, lots of big U.S. companies have foreign
10:31:55AM 16 affiliates, right?

10:31:56AM 17 A. They do.

10:31:57AM 18 Q. And lots of big U.S. companies transfer intangibles
10:32:00AM 19 to foreign affiliates, correct?

10:32:02AM 20 A. They do. But in this case it is unusual, because you
10:32:05AM 21 have the roundtrip motion, where they are transferring it
10:32:07AM 22 out of the United States and then immediately transferring
10:32:09AM 23 it back in.

10:32:10AM 24 Q. And the transfers of intangibles to foreign
10:32:14AM 25 affiliates is so common in our economy that the IRS has an

10:32:22AM 1 entire group devoted solely to looking at these
10:32:26AM 2 transactions, right?

10:32:27AM 3 A. Yeah, Transfer Pricing Operations was stood up to
10:32:31AM 4 make sure that when multinationals were making these
10:32:34AM 5 transfers, the prices were arm's length.

10:32:36AM 6 Q. Right. The core issue is, when you make these
10:32:38AM 7 transactions, was the price arm's length, right?

10:32:41AM 8 A. Correct.

10:32:42AM 9 Q. And you mentioned the Transfer Pricing Operations.
10:32:47AM 10 That's the group that you are in, right?

10:32:48AM 11 A. It is.

10:32:49AM 12 Q. Sometimes called TPO for short, right?

10:32:52AM 13 A. Yes.

10:32:52AM 14 Q. Now, Mr. Weaver talked about how when intangibles are
10:33:07AM 15 transferred that the value -- the so-called arm's length
10:33:14AM 16 value can be calculated in different ways. Were you here
10:33:18AM 17 when he talked about that?

10:33:20AM 18 A. I know -- I don't recall exactly what he said. I
10:33:23AM 19 know that there is an aim when we value these things to
10:33:27AM 20 use the best method that is the most reasonable, accurate
10:33:30AM 21 way of measuring arm's length price. And there are
10:33:34AM 22 different methods. Depending on what your facts are, one
10:33:37AM 23 method may be better than another.

10:33:39AM 24 Q. And without getting into the details of each method,
10:33:41AM 25 there is something called the residual profit split

10:33:44AM 1 **method, right?**

10:33:45AM 2 **A. Amongst others.**

10:33:46AM 3 **Q. Yes, amongst others. And one of the others is the**

10:33:49AM 4 **income method, right?**

10:33:50AM 5 **A. That is another option.**

10:33:53AM 6 **Q. And depending on which methodology you use, you could**

10:33:58AM 7 **come up with dramatically different values for the**

10:34:04AM 8 **intangibles that were transferred, right?**

10:34:06AM 9 **A. Of course. You look for the most accurate one given**

10:34:10AM 10 **your facts and circumstances. And, actually, even when**

10:34:12AM 11 **you are inside a method -- so two people can apply, for**

10:34:19AM 12 **example, a residual profits split method, sometimes I**

10:34:22AM 13 **might call it an RPSM for short, and come up with**

10:34:26AM 14 **different values based on the assumptions they make.**

10:34:30AM 15 **Q. Right. So using different methodologies could come**

10:34:33AM 16 **up with different values, and even using the same**

10:34:36AM 17 **methodology, depending on what assumptions or other inputs**

10:34:41AM 18 **you make, you could come up with dramatically different**

10:34:43AM 19 **values, right?**

10:34:44AM 20 **A. That's true. But the real question is whether those**

10:34:47AM 21 **dramatically different values are reasonable. And if you**

10:34:49AM 22 **look at all the facts and circumstances, it is possible to**

10:34:52AM 23 **come up with one or -- you know, some range that is**

10:34:55AM 24 **reasonable. And if you use assumptions that are**

10:34:57AM 25 **inaccurate, or make mistakes in your math computations, as**

10:35:01AM 1 happened here, you could come up with values that don't
10:35:03AM 2 make any sense, at least not common sense.

10:35:06AM 3 Q. And incidentally, you and your group, you are not the
10:35:11AM 4 final arbiter of whether a particular value makes sense or
10:35:16AM 5 makes common sense, are you?

10:35:18AM 6 A. Well, we determine what the IRS's position is, that
10:35:21AM 7 is, what the IRS thinks is the right number. And, when
10:35:24AM 8 called for, my group is the one that will say what the
10:35:28AM 9 right number is for purposes of a statutory notice of
10:35:31AM 10 deficiency, if we issue one, or, if it goes to appeals, in
10:35:34AM 11 a 30-day letter. After that, obviously, a court can weigh
10:35:39AM 12 in at some point in time. Or if it goes to appeals,
10:35:42AM 13 appeals has an opportunity to consider our analysis and
10:35:47AM 14 enter into a hazards of litigation settlement with
10:35:50AM 15 taxpayers, should they choose, but they are not required
10:35:53AM 16 to.

10:35:53AM 17 Q. Well, courts don't just weigh in -- the tax court,
10:35:57AM 18 for example, they don't just weigh in after you have made
10:35:59AM 19 a determination. What happens is, if you make your own
10:36:03AM 20 determination, and the taxpayer has a determination, and
10:36:07AM 21 you two disagree, and you are not able to resolve it
10:36:12AM 22 through negotiations, it is submitted to the tax court,
10:36:16AM 23 and the tax court is the one that decides what the proper
10:36:19AM 24 value is, right?

10:36:20AM 25 A. Well, they look at our statutory notice of

10:36:22AM 1 deficiency. Normally we are entitled to -- I guess there
10:36:27AM 2 is a burden of proof. Normally -- Unless the taxpayer
10:36:30AM 3 can show that we are arbitrary and capricious, the number
10:36:33AM 4 on the statutory deficiency is supposed to basically be
10:36:37AM 5 upheld.

10:36:38AM 6 Q. How many cases under transfer pricing has the tax
10:36:41AM 7 court decided, where there has been a disagreement between
10:36:45AM 8 the IRS and the taxpayer on the value of the intangibles?

10:36:50AM 9 A. I am only aware of one recent case.

10:36:53AM 10 Q. And that would be the Veritas case that Mr. Weaver
10:36:57AM 11 referred to, right?

10:36:58AM 12 A. Yeah. That was one of the reasons we wanted to look
10:37:00AM 13 at this closer, so we could take into account the
10:37:02AM 14 arguments that Microsoft made in its protest, including
10:37:05AM 15 factual arguments about them saying RPSM was better. And
10:37:10AM 16 we wanted to consider that, so that when we came to our
10:37:14AM 17 recent decision about what the right number was, we had
10:37:16AM 18 actually addressed those issues and considered them.

10:37:18AM 19 Q. Well, in the one case that you are aware of in recent
10:37:21AM 20 years where this kind of issue has been presented to the
10:37:24AM 21 tax court, not only did the tax court disagree with the
10:37:29AM 22 IRS's determination, the tax court said that the IRS had
10:37:35AM 23 acted arbitrarily and capriciously in reaching that
10:37:38AM 24 determination, correct?

10:37:39AM 25 A. Well, the tax court said that our analysis of the

10:37:43AM 1 facts and circumstances was arbitrary and capricious, and
10:37:45AM 2 they criticized us for relying on one expert. The
10:37:49AM 3 taxpayer in that case, I think, they had four or five
10:37:52AM 4 experts. We obviously could do a better job presenting
10:37:55AM 5 complex multifaceted cases, as shown in that court's
10:37:59AM 6 criticisms.

10:38:00AM 7 Q. I take it you would agree that, even today, when you
10:38:09AM 8 are trying to do a better job, the mere fact that the IRS
10:38:14AM 9 and Microsoft disagree about the value of the intangibles
10:38:20AM 10 that were transferred, and thus the tax liability, that
10:38:24AM 11 doesn't mean that the IRS is right and Microsoft is wrong,
10:38:27AM 12 does it?

10:38:27AM 13 A. It depends on what you are focusing on. I have
10:38:31AM 14 identified some things where they are saying inaccurate
10:38:33AM 15 statements in their SEC filings for growth versus what
10:38:36AM 16 they use in their valuation, four percent on their
10:38:39AM 17 valuation versus ten to twelve in their SEC reports. We
10:38:44AM 18 have identified some errors math, which clearly seem like
10:38:47AM 19 errors on Microsoft's part. Those are the kinds of things
10:38:50AM 20 we wanted to engage with Microsoft on, and ask them, "Do
10:38:53AM 21 you really think your numbers are right?", or, "Did you
10:38:55AM 22 make the math errors we pointed out?" "Did you use
10:38:58AM 23 valuation assumptions that were inconsistent with your
10:39:01AM 24 public filings?"

10:39:01AM 25 Q. Incidentally, Microsoft has pointed out math errors,

10:39:05AM 1 and other errors that you have made, too, right?

10:39:08AM 2 A. I am aware of one they pointed out at the

10:39:11AM 3 January 14th presentation. I thanked them and invited

10:39:14AM 4 them to engage on that issue, as well as others.

10:39:15AM 5 Q. In any event, my question was, at the end of the day,

10:39:22AM 6 if you have come up with a tax liability that is

10:39:26AM 7 substantially larger than what Microsoft not only believes

10:39:31AM 8 its tax liability was, but has already paid, then that

10:39:34AM 9 doesn't mean that you're right and Microsoft is wrong,

10:39:37AM 10 that is up to the tax court to decide, right?

10:39:39AM 11 A. If it goes to tax court. But the onus on the IRS in

10:39:44AM 12 the first instance is to say what we think the right

10:39:46AM 13 number is, and to put that right number on a statutory

10:39:48AM 14 notice of deficiency -- or on a 30-day letter first, and

10:39:51AM 15 then on a stat notice if it doesn't get agreed to at

10:39:55AM 16 appeals. Here, we are still trying to get that right

10:39:57AM 17 number. And we want to make sure, given the size of this

10:40:00AM 18 case, the largest I am aware of in the IRS's history, at

10:40:04AM 19 least personally, that we actually kick the tires, and put

10:40:08AM 20 the resources in, and ask the questions, and look at the

10:40:10AM 21 information we need to to make sure that when we put a

10:40:13AM 22 number on the page, it is our reasoned judgment based on

10:40:17AM 23 the facts and circumstances that were available.

10:40:19AM 24 Q. So no matter what someone might say here at the

10:40:26AM 25 lectern about the size of the potential tax liability, you

10:40:32AM 1 haven't even made a determination of that yet, right?

10:40:35AM 2 A. We are still working on getting to the right number.

10:40:38AM 3 There are some issues we obviously raised and wanted to

10:40:41AM 4 engage on on the Americas. That was the purpose of the

10:40:44AM 5 January 14th presentation, which was a preliminary

10:40:46AM 6 analysis with some open questions. And also on the Asia

10:40:50AM 7 Pacific deal, which we never reached resolution

10:40:52AM 8 discussions with the company on, because they shut us down

10:40:55AM 9 on Americas before we could start engaging with them on

10:40:58AM 10 other issues. Those have significant open factual

10:41:00AM 11 questions, which could materially impact what the right

10:41:03AM 12 number is, which we are still trying to get to that right

10:41:05AM 13 number.

10:41:06AM 14 Q. Now, Mr. Weaver mentioned the Veritas case, and you

10:41:13AM 15 said it is the one that you knew of that has actually been

10:41:16AM 16 resolved by the tax court. Are you familiar with the

10:41:19AM 17 Amazon case also?

10:41:20AM 18 A. I am. I thought you were referring to decisions, as

10:41:23AM 19 opposed to currently ongoing litigation.

10:41:25AM 20 Q. I was. This is a different matter. The Amazon case,

10:41:29AM 21 that is also about transfer pricing, right?

10:41:32AM 22 A. It is.

10:41:34AM 23 Q. Where Amazon transferred intangibles to a foreign

10:41:39AM 24 affiliate, and Amazon said we think the value is X, and

10:41:44AM 25 the IRS said we think the value is some multiple of that,

10:41:47AM 1 right?

10:41:48AM 2 A. I believe so. I can't discuss other taxpayers'
10:41:53AM 3 cases. I am sort of limited to what I know from the
10:41:55AM 4 public filings.

10:41:56AM 5 Q. We will keep it limited to what you know from the
10:41:58AM 6 public information. What you do know is that the IRS and
10:42:04AM 7 Amazon were at loggerheads, and they are now in front of
10:42:09AM 8 the tax court, right?

10:42:10AM 9 A. Certainly.

10:42:11AM 10 Q. And that Amazon, just like Veritas, is saying that
10:42:17AM 11 the results that the IRS came up with are arbitrary and
10:42:22AM 12 capricious, right?

10:42:23AM 13 A. I imagine the IRS is holding the same true for
10:42:27AM 14 Amazon's valuation, as being inaccurate and arbitrary as
10:42:29AM 15 well. People disagree in court.

10:42:32AM 16 Q. And it is the court that decides it, not the IRS,
10:42:35AM 17 right?

10:42:35AM 18 A. Well, the IRS isn't a court. Obviously in this case
10:42:42AM 19 Amazon is before the tax court.

10:42:43AM 20 Q. Now, we heard from Mr. Weaver that, well, the reason
10:42:54AM 21 that Mr. Hoory and the Transfer Pricing Operations people
10:43:03AM 22 hired Quinn Emanuel is because they really want to make
10:43:10AM 23 sure that the audit was done correctly. Did you hear him
10:43:16AM 24 say that?

10:43:17AM 25 A. I don't recall him saying those words.

10:43:19AM 1 Q. Well, no, not those words. But didn't you get the
10:43:24AM 2 impression from Mr. Weaver that his story is that the real
10:43:30AM 3 reason that you got Quinn Emanuel involved was because
10:43:35AM 4 there had been foul-ups in the Veritas audit, and they
10:43:39AM 5 hadn't done a good job putting all the facts together, and
10:43:44AM 6 so you wanted to hire a commercial litigator who could do
10:43:48AM 7 a good job of analyzing all these facts during the
10:43:51AM 8 examination, i.e., during the audit?

10:43:54AM 9 A. What I heard him say, and the way I think about the
10:43:57AM 10 Quinn Emanuel contract, is that we recognize that transfer
10:44:01AM 11 pricing cases are very complex, they deal with very
10:44:04AM 12 complex facts, lots of different issues. In this case we
10:44:07AM 13 knew that we needed multiple experts to get to what the
10:44:10AM 14 right number was, as well as lots of information. And we
10:44:13AM 15 thought that a commercial litigator with experience in
10:44:17AM 16 very complex cases could bring some value to the table,
10:44:20AM 17 first in providing a sounding board, a gut check for the
10:44:23AM 18 IRS, look at what we have done to date, and what the
10:44:26AM 19 taxpayer put on the table, and make observations,
10:44:30AM 20 hopefully thoughtful, helpful ones, that would ask good
10:44:33AM 21 questions. And if we had open areas that we needed to
10:44:35AM 22 develop further, or things that didn't make sense, we
10:44:38AM 23 wanted to know that, and do the best job we could to get
10:44:41AM 24 to the right number. That is why we hired Quinn Emanuel
10:44:44AM 25 at the examination stage, to provide that kind of legal

10:44:47AM 1 consultation and advice, which it appeared would be
10:44:50AM 2 something that a complex commercial litigator would have.

10:44:55AM 3 THE COURT: Mr. Beck, let's go ahead and take our
10:44:58AM 4 morning recess for our court reporter at this point in
10:45:00AM 5 time. We will come back in 15 minutes.

11:06:18AM 6 (Break.)

11:06:18AM 7 THE COURT: Counsel, we are back in session.

11:06:21AM 8 Mr. Beck.

11:06:24AM 9 MR. BECK: Thank you, your Honor.

11:06:26AM 10 By Mr. Beck:

11:06:26AM 11 Q. When we left off we were talking about what
11:06:29AM 12 Mr. Weaver had said and what you had said on the stand
11:06:31AM 13 about what Quinn Emanuel was hired for. My notes from
11:06:37AM 14 Mr. Weaver's opening, he said that you decided to hire
11:06:42AM 15 some other types of experts in 2012 to help with the
11:06:46AM 16 examination for the audit, right?

11:06:50AM 17 A. Yes.

11:06:52AM 18 Q. And that later on you decided that it would also be
11:06:56AM 19 useful in the examination or audit to have the services of
11:07:02AM 20 a commercial litigator, right?

11:07:03AM 21 A. Correct. Initially we pursued Boies Schiller.

11:07:08AM 22 Q. And Boies -- David Boies had some sort of a conflict,
11:07:13AM 23 so I guess your next pick was John Quinn, right?

11:07:16AM 24 A. Yeah. We looked for other people with similar
11:07:18AM 25 expertise, because we still saw value in that expertise,

11:07:23AM 1 and eventually we picked Quinn Emanuel.

11:07:25AM 2 Q. And, again, getting back to what Mr. Weaver said and
11:07:28AM 3 what you said on the stand, you both said that the reason
11:07:31AM 4 that you hired Quinn Emanuel was to reach sound
11:07:36AM 5 conclusions in the examination, in the audit, right?

11:07:40AM 6 A. That was the initial focus, and that was the contract
11:07:44AM 7 that was actually awarded, was for examination support and
11:07:48AM 8 evaluation.

11:07:48AM 9 Q. And as I wrote it down, Mr. Weaver said, to be clear,
11:07:53AM 10 if the examination was not resolved at the audit stage,
11:08:01AM 11 these same lawyers might be involved in later litigation?

11:08:06AM 12 A. That's right. That is the same as any expert.
11:08:09AM 13 Whenever we hire an expert at the examination stage, we
11:08:12AM 14 always want to make sure that they are someone that we
11:08:14AM 15 would trust, if we were not to reach resolution with the
11:08:17AM 16 taxpayer, and if the case would go forward, whether to
11:08:21AM 17 appeals or to tax court.

11:08:23AM 18 Q. Actually, sir, wasn't it kind of the other way
11:08:26AM 19 around, where the endgame and core purpose of hiring Quinn
11:08:33AM 20 Emanuel was for them to represent you in the tax court,
11:08:39AM 21 and their involvement at the audit stage was just a way
11:08:44AM 22 for them to take some free pretrial discovery that they
11:08:48AM 23 could never get out of the tax court?

11:08:49AM 24 A. That is incorrect.

11:08:51AM 25 Q. Well, who is John Koskinen? I may be pronouncing

11:09:00AM 1 that incorrectly.

11:09:01AM 2 A. He is the current commissioner of the IRS.

11:09:03AM 3 Q. He is like your boss' boss' boss?

11:09:09AM 4 A. Do you want me to count?

11:09:11AM 5 Q. Well, he is the top man at the IRS, right?

11:09:13AM 6 A. Yeah, he is three or four levels above.

11:09:17AM 7 Q. The top person at the IRS, correct?

11:09:19AM 8 A. That is my understanding.

11:09:22AM 9 Q. Let's take a look at what he said on this subject,

11:09:27AM 10 looking at our Exhibit 54, which is an article from Tax

11:09:32AM 11 Notes.

11:09:37AM 12 MR. WEAVER: Objection. Foundation, your Honor.

11:09:48AM 13 THE COURT: I don't know what question you are
11:09:50AM 14 going to ask him, Mr. Beck.

11:09:55AM 15 MR. BECK: I am going to show him what

11:09:57AM 16 Mr. Koskinen said, and ask him whether he agrees with
11:10:01AM 17 that.

11:10:02AM 18 MR. WEAVER: If Mr. Hoory recognizes this
11:10:04AM 19 document, that would be fine. But that assumes that
11:10:06AM 20 Mr. Koskinen said what he said, and Mr. Hoory is familiar
11:10:10AM 21 with this document.

11:10:11AM 22 MR. BECK: Your Honor, we are also in a hearing,
11:10:13AM 23 the purpose of which is to determine whether we should be
11:10:17AM 24 allowed to take some discovery in this case.

11:10:19AM 25 THE COURT: Mr. Beck, I'm fine. Counsel, while

11:10:23AM 1 the rules of evidence obviously apply, they will be
11:10:27AM 2 relaxed to a certain extent simply because of the purposes
11:10:30AM 3 of this particular hearing. We will allow your
11:10:34AM 4 questioning, Mr. Beck.

11:10:35AM 5 MR. BECK: Thank you.

11:10:36AM 6 By Mr. Beck:

11:10:39AM 7 Q. So here in this publication it indicates there in the
11:10:42AM 8 highlighted portion that Commissioner Koskinen was
11:10:48AM 9 speaking in Washington at the Annual Institute on Current
11:10:52AM 10 Issues in International Taxation. Do you see that?

11:10:58AM 11 A. I see the sentence.

11:10:59AM 12 Q. Were you there by any chance?

11:11:02AM 13 A. I was not.

11:11:03AM 14 Q. Over here on Page 3, on outsourcing audit work --
11:11:17AM 15 Let me blow that up a little bit. Speaking with tax
11:11:21AM 16 analysts after the session, Koskinen defended the IRS's
11:11:27AM 17 decision to outsource \$2 million of work on Microsoft's
11:11:30AM 18 transfer pricing audit to the law firm Quinn Emanuel. And
11:11:36AM 19 then down below in the highlighted portion quotes the
11:11:39AM 20 commissioner as saying, "One of the things that we have to
11:11:43AM 21 do is show up in tax court," the commissioner said. "We
11:11:48AM 22 can't default the government's position simply because we
11:11:51AM 23 have 20 percent fewer members of the Office of Chief
11:11:54AM 24 Counsel than we used to have. The one place we can't cut
11:11:57AM 25 resources is in tax litigation."

11:12:00AM 1 Now, in fact, sir, wasn't the core purpose and
11:12:04AM 2 justification for spending \$2 million on Quinn Emanuel was
11:12:09AM 3 that you wanted them to be your trial lawyers in tax court
11:12:13AM 4 down the road?

11:12:15AM 5 A. Let me be very clear. Quinn Emanuel was hired for
11:12:19AM 6 examination support and to help with the evaluation. We
11:12:22AM 7 knew there was a possibility, just like in any case -- any
11:12:25AM 8 audit, any examination, that there would be a
11:12:28AM 9 disagreement. And whenever there is a disagreement -- In
11:12:30AM 10 this case that seemed likely, given the past history and
11:12:33AM 11 the size and the difference of issues, notwithstanding
11:12:36AM 12 that we thought we still needed to do work to get the
11:12:38AM 13 right number, and notwithstanding that we wanted to have
11:12:40AM 14 resolution, that we might not agree with the taxpayer at
11:12:43AM 15 the end of the day, and we might not seek resolution.

11:12:45AM 16 In that case -- In every case, the IRS, the
11:12:48AM 17 examination function that I work for, we need to come up
11:12:51AM 18 with the right number and present it well. And we need to
11:12:54AM 19 make sure that we have the right facts. The first step is
11:12:57AM 20 always to get to that right number.

11:12:59AM 21 And once we put that right number down on paper,
11:13:01AM 22 whether it goes to appeals or tax court, we have to defend
11:13:03AM 23 it. If it doesn't go to appeals, and it goes to tax
11:13:07AM 24 court, we have to be prepared to litigate.

11:13:09AM 25 And when we don't develop cases as well as we might

11:13:11AM 1 otherwise have, and we put a number on the paper that
11:13:14AM 2 isn't fully supported by the facts, or we haven't fully
11:13:17AM 3 developed the facts, in those situations we are not ready
11:13:21AM 4 to defend it, whether it is in appeals or in court. So
11:13:26AM 5 our goal is to get to the right number and be ready for
11:13:28AM 6 whatever comes.

11:13:30AM 7 Q. In the Veritas case, the lawyers who represented the
11:13:37AM 8 IRS in tax court were lawyers from the IRS Chief Counsel's
11:13:41AM 9 office, right?

11:13:42AM 10 A. Yes.

11:13:43AM 11 Q. And before you hired Quinn Emanuel, had you in fact
11:13:52AM 12 discussed with colleagues in the IRS your view that the
11:13:56AM 13 lawyers from the Chief Counsel's office had not done a
11:14:00AM 14 very good job in the Veritas tax court case?

11:14:06AM 15 A. What I discussed with colleagues was that the Veritas
11:14:10AM 16 tax court case seemed to highlight a number of areas we
11:14:13AM 17 could do better in, particularly our development of the
11:14:17AM 18 facts, us actually diving into the taxpayer's methodology
11:14:23AM 19 and testing it, to look at the activities that the
11:14:26AM 20 companies performed. In that case they focused a lot on
11:14:30AM 21 sales and marketing activities performed by the European
11:14:34AM 22 affiliate.

11:14:35AM 23 Here, we really needed to dive into the sales and
11:14:37AM 24 marketing activities that the U.S. continued to perform.
11:14:40AM 25 We thought we could do a better job presenting it, and

11:14:44AM 1 bringing better expertise to the table.

11:14:46AM 2 In Veritas we relied, from my understanding at
11:14:47AM 3 least -- and I only know what is in the tax court opinion,
11:14:50AM 4 since I wasn't privy to the case, the IRS relied on a
11:14:53AM 5 single economist expert. On the other side they had an
11:14:55AM 6 economist, they had a code expert, they had a marketing
11:14:58AM 7 expert, and they had a financial expert. We clearly could
11:15:02AM 8 do a better job bringing the right expertise to bear and
11:15:07AM 9 developing the facts and presenting them.

11:15:08AM 10 We thought that litigators who have experience with a
11:15:15AM 11 large bandwidth of cases of that variety, that complexity,
11:15:19AM 12 would be more likely, day in and day out, to have
11:15:22AM 13 encountered those kinds of issues and could bring some
11:15:24AM 14 value to the table.

11:15:25AM 15 We don't litigate a lot of transfer pricing cases. As
11:15:29AM 16 I mentioned, Veritas is the only real fact-intensive case
11:15:34AM 17 that I am aware of having been decided in the last decade
11:15:37AM 18 or so.

11:15:38AM 19 Q. In all that long answer of yours, that all related to
11:15:40AM 20 what happened in the tax court, right?

11:15:42AM 21 A. Yeah. We need to put the right number and support it
11:15:45AM 22 when we issue -- whether it is, frankly, a 30-day letter
11:15:49AM 23 or a statutory notice of deficiency. So we need to make
11:15:52AM 24 sure we have done our job when we put a number on the
11:15:55AM 25 paper. If we don't do that, then it is not going to stand

11:15:57AM 1 up in any forum, whether it is appeals or tax court.

11:16:00AM 2 Q. Please listen to my question carefully and see if you
11:16:03AM 3 can answer it. Did you talk with colleagues at the IRS
11:16:11AM 4 before you hired Quinn Emanuel about your concern that the
11:16:17AM 5 folks from the Chief Counsel's office of the IRS had not
11:16:20AM 6 done a good enough job in the tax court?

11:16:25AM 7 MR. WEAVER: Objection, to the extent that the
11:16:27AM 8 question calls for privileged communications with IRS
11:16:32AM 9 counsel or deliberative communications.

11:16:34AM 10 THE COURT: Are you asking him to state whether or
11:16:38AM 11 not that was his opinion?

11:16:41AM 12 MR. BECK: I will ask it that way.

11:16:43AM 13 By Mr. Beck:

11:16:43AM 14 Q. It was your opinion, was it not, sir, setting aside
11:16:50AM 15 any questions about how the audit was conducted, that the
11:16:53AM 16 lawyers from the Chief Counsel's office in the IRS had not
11:16:59AM 17 done a good job in the tax court?

11:17:03AM 18 A. If you are asking me for my opinion, my opinion,
11:17:07AM 19 looking at the outcome of Veritas, was that the opinion
11:17:11AM 20 highlighted a number of areas that the IRS as a whole
11:17:14AM 21 could do better at. And one of the key pieces was that we
11:17:20AM 22 switched positions between our examination piece and the
11:17:23AM 23 counsel piece. Obviously counsel had a role to play in
11:17:27AM 24 that, just like examination had a role to play in the
11:17:29AM 25 outcome of that decision. We, the IRS as a whole, it

11:17:33AM 1 looked like we could do a better job developing the facts.
11:17:36AM 2 If that means that counsel could have done a better job,
11:17:39AM 3 then, certainly, they could have done a better job as
11:17:41AM 4 well, just like exam could do a better job. And that's
11:17:46AM 5 what we are trying to do.

11:17:47AM 6 Q. Did you tell people in the IRS -- not in any
11:17:49AM 7 privileged communication, lawyer-client, did you tell your
11:17:54AM 8 colleagues that we need to bring in David Boies or John
11:17:57AM 9 Quinn, or whomever, because the guys who did the job in
11:18:02AM 10 the tax court fouled it all up and we want first-class
11:18:06AM 11 trial lawyers in the tax court?

11:18:12AM 12 A. I don't recall ever making those statements.

11:18:14AM 13 Q. I am not asking word for word. Did you say that in
11:18:17AM 14 substance to anybody at the IRS, other than if you were
11:18:22AM 15 seeking legal advice?

11:18:25AM 16 MR. WEAVER: Objection to the extent that the
11:18:29AM 17 question calls for deliberations that are pre-decisional
11:18:32AM 18 in nature.

11:18:35AM 19 MR. BECK: Your Honor, I guess that doesn't make
11:18:37AM 20 any sense to me. The idea about whether he told somebody
11:18:40AM 21 that we need good lawyers in the tax court because the
11:18:43AM 22 other guys fouled it up, it is inconceivable to me how
11:18:49AM 23 that could be pre-deliberative as to any decision.

11:18:52AM 24 THE COURT: The objection will be overruled.

11:18:54AM 25 Mr. Hoory, can you answer the question? Did you ever make

11:18:56AM 1 that kind of statement?

11:18:57AM 2 THE WITNESS: I don't believe so. The kind of
11:18:59AM 3 statements that I recall making are consistent with what I
11:19:01AM 4 just explained, that we thought that people with more
11:19:05AM 5 expertise, more volume of cases, who worked with these
11:19:09AM 6 multifaceted, very complex issues, whether it was
11:19:13AM 7 intellectual property or antitrust, they could bring value
11:19:16AM 8 to the table. That was the premise. That was the value
11:19:18AM 9 we saw in bringing a Boies Schiller or a Quinn Emanuel to
11:19:23AM 10 give us their legal advice and consultation, to bring that
11:19:26AM 11 expertise. Because at the IRS we simply don't deal with
11:19:30AM 12 that volume, we don't litigate that many cases.

11:19:32AM 13 Mr. Beck:

11:19:32AM 14 Q. And give me the names of the people that you say you
11:19:35AM 15 said that to in case we get discovery and we can inquire
11:19:39AM 16 as to what they recollect you saying. Who did you have
11:19:44AM 17 these conversations with?

11:19:46AM 18 A. So obviously we discussed the premise with
11:19:50AM 19 Mr. Maruca. He is my boss. We had some discussions, I
11:19:58AM 20 would say, at some point, with Mr. Maruca's boss,
11:20:09AM 21 Mr. Danilack. At some point we eventually discussed it
11:20:13AM 22 with Ms. Maloy. On the counsel side, we discussed it
11:20:21AM 23 with, you know, various persons, in counsel as well.

11:20:27AM 24 Q. Moving on to another subject here. You understand
11:20:34AM 25 that one of the big questions in whether your summonses

11:20:43AM 1 should be enforced is whether private attorneys at Quinn
11:20:50AM 2 Emanuel can put people under oath and take testimony from
11:20:52AM 3 them, right?

11:20:53AM 4 A. I understand it to be that whether contractors that
11:20:57AM 5 we hire, whether it is Quinn Emanuel or our substantive
11:21:01AM 6 experts, who were also in attendance at these interviews,
11:21:04AM 7 could ask questions at summons interviews that the IRS has
11:21:08AM 8 requested of taxpayers, or third parties.

11:21:10AM 9 Q. Well, there are interviews and then there are
11:21:16AM 10 interviews where people are put under oath and give sworn
11:21:19AM 11 testimony. You understand those are two different
11:21:22AM 12 animals, right?

11:21:22AM 13 A. Well, there is Q&A and formal Q&A that is not under
11:21:27AM 14 oath, and then there is question and answer that is under
11:21:30AM 15 oath. The only reason I was distinguishing what you said
11:21:32AM 16 from my understanding was because you suggested, or at
11:21:34AM 17 least I understood you to suggest, that Quinn Emanuel was
11:21:37AM 18 placing these people under oath. And that is not what
11:21:39AM 19 happens.

11:21:39AM 20 Q. It is not who places them under oath. I am trying to
11:21:44AM 21 focus on who is going to be asking the questions. And
11:21:48AM 22 what you have told Microsoft in no uncertain terms is that
11:21:52AM 23 if these summonses are enforced, Quinn Emanuel can fully
11:21:58AM 24 participate and take the lead, being the people asking the
11:22:04AM 25 questions and taking the testimony, right?

11:22:06AM 1 **A. What I told them was that all of our experts would be**
11:22:12AM 2 **free, if we asked them to, to attend the interviews and**
11:22:15AM 3 **fully participate by asking questions. That includes our**
11:22:19AM 4 **industry experts as well.**

11:22:20AM 5 **Q. I am just asking about Quinn Emanuel. Didn't you**
11:22:22AM 6 **tell them that if these summonses are enforced, Quinn**
11:22:26AM 7 **Emanuel is going to be, from your point of view, able to**
11:22:30AM 8 **attend all of these depositions or sworn interviews and be**
11:22:36AM 9 **the ones who ask the questions and get the answers?**

11:22:39AM 10 **A. Amongst other people, yes. I said that they would**
11:22:44AM 11 **attend if I asked them to, and that they may fully**
11:22:47AM 12 **participate, just like it says in the regulation.**

11:22:49AM 13 **Q. You said, "like it says in the regulation." Your**
11:22:52AM 14 **legal basis, justification for saying that Quinn Emanuel**
11:22:59AM 15 **ought to be able to do that is this temporary regulation**
11:23:01AM 16 **you referred to, right?**

11:23:03AM 17 **MR. WEAVER: Objection. Calls for legal analysis.**
11:23:05AM 18 **This is a fact witness, your Honor.**

11:23:07AM 19 **THE COURT: The objection as to the form will be**
11:23:10AM 20 **sustained.**

11:23:13AM 21 **By Mr. Beck:**

11:23:13AM 22 **Q. When you say as the regulation says, what are you**
11:23:16AM 23 **talking about in your answer to me? When you volunteered**
11:23:22AM 24 **that this was all as provided for in the regulation, what**
11:23:25AM 25 **are you talking about?**

11:23:26AM 1 A. It is the same regulation that is referred to in
11:23:29AM 2 correspondence between myself and Mr. Bernard or
11:23:33AM 3 Mr. O'Brien. I think, if I have it right, it is
11:23:41AM 4 301.7602-1, subparagraph something or other.

11:23:45AM 5 Q. In fact, you, when writing to Microsoft -- And they
11:23:53AM 6 had objected to Quinn Emanuel participating in any kind of
11:23:57AM 7 asking questions on sworn testimony, right?

11:24:00AM 8 A. At some point they did, yes.

11:24:02AM 9 Q. And what you did is, you wrote back and you said, "As
11:24:07AM 10 you no doubt are aware, this is authorized under the
11:24:11AM 11 temporary regulation," right?

11:24:12AM 12 A. I wanted to make sure they were aware of it, yes.

11:24:14AM 13 Q. Your position, as you communicated to Microsoft, was
11:24:17AM 14 that the authority for Quinn Emanuel to ask questions and
11:24:24AM 15 take testimony was this temporary regulation, right?

11:24:27AM 16 MR. WEAVER: Objection, your Honor. Again, the
11:24:29AM 17 framing of the question calls for legal authority. It is
11:24:32AM 18 not a fact question.

11:24:35AM 19 MR. BECK: I asked what he communicated to
11:24:37AM 20 Microsoft.

11:24:37AM 21 THE COURT: The objection will be overruled. Is
11:24:40AM 22 that what you told Microsoft?

11:24:42AM 23 THE WITNESS: I think my letter clearly refers to
11:24:44AM 24 the regulation. And it says -- assumes that they are
11:24:48AM 25 aware of it, because they are a very sophisticated

11:24:50AM 1 **taxpayer, and they are advised by sophisticated tax**
11:24:53AM 2 **counsel. If they didn't, it obviously made them aware of**
11:24:57AM 3 **it. I don't know if they were or were not aware of it at**
11:24:59AM 4 **that point.**

11:24:59AM 5 **Mr. Beck:**

11:25:00AM 6 **Q. I didn't ask whether they were aware or not aware of**
11:25:02AM 7 **it. What I asked is, when Microsoft objected to Quinn**
11:25:08AM 8 **Emanuel taking sworn testimony, what you said to Microsoft**
11:25:12AM 9 **is that the authority for Quinn Emanuel to do that is in**
11:25:18AM 10 **the temporary regulation; isn't that true?**

11:25:21AM 11 **A. I don't remember my exact phrasing. I certainly said**
11:25:23AM 12 **that the reg permits our experts to attend and fully**
11:25:28AM 13 **participate.**

11:25:28AM 14 **Q. Well, we will come back to your exact phrasing a**
11:25:32AM 15 **little later. Let's take a look at the regulation here.**
11:25:57AM 16 **Just the title of it says, "Participation of a person**
11:26:00AM 17 **described in Section 6103(n) in a summons interview under**
11:26:06AM 18 **Section 7602(a)(2) of the Internal Revenue Code." Do you**
11:26:12AM 19 **see that?**

11:26:12AM 20 **A. I do.**

11:26:13AM 21 **Q. You are familiar with both of these provisions,**
11:26:16AM 22 **right?**

11:26:16AM 23 **A. I can't quote them to you, but basically.**

11:26:17AM 24 **Q. But you are familiar with them, aren't you?**

11:26:20AM 25 **A. I said "basically."**

11:26:21AM 1 **Q.** Incidentally, you are a lawyer, right?

11:26:24AM 2 **A.** I am an attorney, but I don't work as an attorney in

11:26:28AM 3 my current capacity.

11:26:30AM 4 **Q.** You are in fact trained as a tax lawyer, right?

11:26:33AM 5 **A.** I have experience as a tax attorney.

11:26:36AM 6 **Q.** Years and years of experience as a tax attorney,

11:26:38AM 7 right?

11:26:39AM 8 **A.** Probably about ten -- Well, I practiced for six

11:26:44AM 9 years or so.

11:26:45AM 10 **Q.** At one of the leading firms in the country, right?

11:26:48AM 11 **A.** Thank you.

11:26:52AM 12 **Q.** Covington & Burling, right?

11:26:54AM 13 **A.** Yes.

11:26:55AM 14 **Q.** As a tax attorney all that time, right?

11:26:57AM 15 **A.** Yes.

11:26:58AM 16 **Q.** Now, do you understand that Section 7602 is about who

11:27:04AM 17 can take testimony in a summons interview?

11:27:18AM 18 MR. WEAVER: Your Honor, let me just object. To

11:27:20AM 19 the extent that Mr. Hoory is going to be used as a witness

11:27:23AM 20 to interpret the reg, I believe that is improper. If it

11:27:29AM 21 is his understanding as it relates to the Microsoft audit,

11:27:32AM 22 fine. I don't know that it is relevant. I am worried

11:27:35AM 23 that Mr. Hoory is being set up here, because of his legal

11:27:39AM 24 experience, to somehow now start opining on behalf of the

11:27:42AM 25 IRS about this reg. That is not appropriate.

11:27:44AM 1 THE COURT: Thank you. Mr. Beck, I don't believe
11:27:52AM 2 that is where you are going, right? We are trying to get
11:27:55AM 3 to the factual answers here, correct?

11:27:58AM 4 MR. BECK: Yes. But I think, your Honor, part of
11:28:01AM 5 the question concerning whether there was a proper purpose
11:28:04AM 6 and whether this was abusive requires a basic
11:28:08AM 7 understanding of the statutory scheme, which this
11:28:12AM 8 gentleman clearly had. And he participated, in fact, in
11:28:16AM 9 reviewing regulations that purported to be based on these
11:28:25AM 10 statutory provisions. So as a factual matter, he had to
11:28:29AM 11 have some kind of understanding of the statute in order to
11:28:34AM 12 participate in the deliberations concerning the
11:28:36AM 13 regulations.

11:28:36AM 14 THE COURT: His understanding of the statute is
11:28:38AM 15 not at issue. It will be up to the court to make that
11:28:42AM 16 determination. His understanding of the statute as to how
11:28:44AM 17 it affects what he may have done factually is relevant
11:28:49AM 18 here. If that's the way you want to go, then fine.
11:28:53AM 19 Otherwise, Mr. Weaver's objection is correct.

11:28:56AM 20 MR. BECK: Well, I actually wanted to kind of
11:29:00AM 21 debate him about the meaning of the statute.

11:29:03AM 22 THE COURT: I don't see why you want to waste the
11:29:05AM 23 time. It will be up to me to decide what that statute
11:29:08AM 24 means.

11:29:13AM 25 By Mr. Beck:

11:29:14AM 1 Q. Let me ask you, 7602 -- And this really is directed
11:29:19AM 2 towards factual testimony. You heard Mr. Weaver's
11:29:24AM 3 explanation of -- his interpretation of 7602, correct?
11:29:28AM 4 A. During his opening, yes.
11:29:30AM 5 Q. Now, for years, the industry experts, like
11:29:38AM 6 economists, and engineers, and accountants had
11:29:42AM 7 participated in summons interviews, right?
11:29:47AM 8 A. That's my understanding.
11:29:50AM 9 Q. But is it also your understanding as a factual matter
11:29:55AM 10 that these summons interviews where experts participated
11:30:04AM 11 in were never -- almost never under oath?
11:30:12AM 12 A. I can only speak to my tenure at the IRS. What I can
11:30:18AM 13 tell you is that when we stood up TPO and looked at what
11:30:24AM 14 we could do better, one of the things we noticed was that
11:30:27AM 15 we had difficulty referring to interviews because some
11:30:30AM 16 were under oath and some were not. And particularly on
11:30:34AM 17 the ones that were not, you know, similar to the point
11:30:37AM 18 that Microsoft made in its protest, you know, basically it
11:30:41AM 19 is tough to rely on someone's handwritten notes, what is
11:30:47AM 20 in there, what is not. Somebody who is not part of the
11:30:49AM 21 examination and not actually at the interview can't really
11:30:52AM 22 evaluate those notes. If we are trying to develop it and
11:30:55AM 23 give it to another expert that we bring on board later, we
11:30:57AM 24 really need a transcript, if we think we are going to rely
11:31:01AM 25 on that.

11:31:01AM 1 Similarly, if we send the case to appeals, the appeals
11:31:05AM 2 officer really needs a transcript to see what was said.
11:31:08AM 3 So one of the goals we had was, notwithstanding that in
11:31:11AM 4 the past at the examination stage we had not done
11:31:15AM 5 transcripts that often -- In other words, it wasn't that
11:31:17AM 6 it never happened, it just didn't happen that often. One
11:31:20AM 7 of the pushes was, if you get to the stage that you need
11:31:22AM 8 to talk to people, like after you have just done the
11:31:24AM 9 preliminary back and forth to try to ask intelligent
11:31:28AM 10 questions, if you still have material issues in dispute,
11:31:31AM 11 one of the pushes we started to make was to have them
11:31:34AM 12 under oath on a transcript so there would be a record.
11:31:37AM 13 Q. Well, you didn't really start to make that push until
11:31:41AM 14 you hired Quinn Emanuel in the Microsoft audit, right?
11:31:45AM 15 A. That's incorrect. We made that push in other cases.
11:31:49AM 16 In Microsoft we were trying to use resources efficiently
11:31:54AM 17 and to respect not just our use of our own resources, but
11:31:58AM 18 the company's requests of us, and the fact that the audit
11:32:04AM 19 had gone on for a while, and that we were trying to
11:32:07AM 20 resolve and narrow issues. Mr. Bernard was actually the
11:32:11AM 21 one who asked me to only use informal interviews very
11:32:17AM 22 early on us reopening the case, withdrawing the 30-day
11:32:18AM 23 letter. He is the one who said, "Hey, this has worked out
11:32:21AM 24 well for Microsoft in the past, you know, you guys seemed
11:32:23AM 25 to get what you wanted, how about we do this?" And I

11:32:24AM 1 agreed, subject to the caveat, which is reflected in our
11:32:27AM 2 updated timelines after that occurred, that we reserve the
11:32:31AM 3 right to do formal interviews -- formal under oath
11:32:34AM 4 interviews.

11:32:35AM 5 Once resolution talks broke down and we had not
11:32:38AM 6 narrowed issues, then we knew exactly what was open, what
11:32:41AM 7 issues we thought we had to develop. And at that point in
11:32:44AM 8 time we thought, "Is it worth investing the energy now on
11:32:49AM 9 our part and on Microsoft's?" And the answer was clearly
11:32:52AM 10 yes. This is a huge issue. We needed to know what their
11:32:54AM 11 businesspeople thought of their various competitive
11:32:58AM 12 advantages, the things that are at issue in the valuation.

11:33:00AM 13 And we had not yet talked to the KPMG people on the
11:33:05AM 14 record, or the internal tax folks on the record, and we
11:33:08AM 15 asked to at the appropriate time, which is when Microsoft
11:33:11AM 16 told us that they did not want to narrow any issues, and
11:33:15AM 17 that we basically had to develop every open issue. And
11:33:19AM 18 the way to do that with witnesses is to get them on the
11:33:21AM 19 record.

11:33:23AM 20 Q. Well, focusing on Microsoft, this audit that began in
11:33:29AM 21 2007. From 2007, 2008, 2009, 2010, 2011, 2012, 2013, all
11:33:42AM 22 the way up until Quinn Emanuel got on the scene, had you
11:33:50AM 23 ever had a single one of the interviews where people were
11:33:55AM 24 put under oath and a court reporter transcribed the
11:34:00AM 25 questions and answers?

11:34:00AM 1 A. Yes, we did. I think we had two to three interviews
11:34:04AM 2 under oath in the aQuantive acquisition that we were
11:34:09AM 3 auditing for Microsoft. Those occurred prior to the
11:34:12AM 4 September and October interviews that took place in this
11:34:14AM 5 case.

11:34:14AM 6 Q. I am talking now about the transfer pricing audit
11:34:17AM 7 that you were doing. Is that what you are talking about?

11:34:20AM 8 A. That was a transfer pricing issue. It was in the
11:34:24AM 9 07/09 cycle. That interview occurred on a transfer
11:34:28AM 10 pricing issue, under oath, with several Microsoft current
11:34:31AM 11 or former employees.

11:34:32AM 12 Q. So now you are talking about a different audit for
11:34:34AM 13 different tax years, right?

11:34:34AM 14 A. Well, it is related to this one in part, because --

11:34:36AM 15 Q. Are you talking about a different audit for different
11:34:38AM 16 tax years?

11:34:39AM 17 MR. WEAVER: Objection, your Honor.

11:34:40AM 18 MR. BECK: Your Honor, we are never going to get
11:34:42AM 19 done today if I get ten minute answers for yes or no
11:34:45AM 20 questions.

11:34:48AM 21 THE COURT: Mr. Hoory, I need you to do your best
11:34:50AM 22 to answer his questions in a much shorter fashion.

11:34:54AM 23 THE WITNESS: I will do my best, your Honor.

11:34:57AM 24 THE COURT: Ask him another question, counsel.

11:35:01AM 25 By Mr. Beck:

11:35:01AM 1 Q. Were you just talking about a different audit for
11:35:03AM 2 different tax years?

11:35:04AM 3 A. I was talking about the 07/09 audit. It has
11:35:07AM 4 overlapping transfer pricing issues with the 04/06 audit.

11:35:11AM 5 Q. Different audit, different tax years, right?

11:35:13AM 6 A. Related audit, different tax years.

11:35:15AM 7 Q. Now, in the audit that we have been talking about, in
11:35:20AM 8 all these years, '07, '08, '09, '10, '11, '12, '13, and
11:35:28AM 9 the audit that is the subject of this litigation, before
11:35:31AM 10 Quinn Emanuel got involved, had you ever conducted an
11:35:36AM 11 interview where somebody was put under oath and a
11:35:39AM 12 transcript was made of the questions and answers?

11:35:41AM 13 A. I am not aware of an interview under oath in the
11:35:45AM 14 04/06 cycle prior to the ones in September and October.

11:35:53AM 15 Q. I think you said that things changed and you decided
11:36:01AM 16 that you wanted people under oath, and I wrote down your
11:36:05AM 17 words, and I am quoting here, "once resolution talks broke
11:36:09AM 18 down." As I understand it, sir, once it became clear that
11:36:17AM 19 you weren't going to be able to resolve this by agreement,
11:36:22AM 20 and that you were headed to the tax court, that's when you
11:36:27AM 21 and Quinn Emanuel decided that interviews ought to be
11:36:33AM 22 under oath and transcribed, right?

11:36:35AM 23 A. That's incorrect. Quinn Emanuel did not make the
11:36:39AM 24 decision, the IRS did.

11:36:40AM 25 Q. So we will take -- Well, did you talk to Quinn

11:36:47AM 1 Emanuel about it?

11:36:47AM 2 A. Not about the decision to seek interviews at that
11:36:49AM 3 time. So I communicated, I believe in February --

11:36:52AM 4 Q. I am talking about the decision that the interviews
11:36:56AM 5 that took place -- The first time you had people under
11:36:59AM 6 oath and transcribed it was in the fall of 2014, right?

11:37:03AM 7 A. Yes. But the decision to seek under oath interviews
11:37:06AM 8 was made long before that.

11:37:08AM 9 Q. And are you saying that before those interviews took
11:37:13AM 10 place, you never had any conversations with Quinn Emanuel
11:37:16AM 11 about whether people ought to be put under oath and the
11:37:22AM 12 questions and answers ought to be transcribed?

11:37:24AM 13 A. I don't recall ever discussing whether or not they
11:37:27AM 14 should be transcribed. What I recall, and you can see
11:37:32AM 15 references in the contract, that we anticipated, long
11:37:35AM 16 before Quinn Emanuel did any substantive work, that we may
11:37:39AM 17 want to do interviews, and that if we did, we may want
11:37:43AM 18 them to be present, just like we would with any expert
11:37:45AM 19 that we hire.

11:37:46AM 20 Q. In any event, whoever made the decision, and whoever
11:37:49AM 21 you consulted with, your testimony was that you decided
11:37:53AM 22 you wanted under oath transcripts once resolution talks
11:37:59AM 23 broke down, right?

11:38:00AM 24 A. We identified the need prior to that, but we wanted
11:38:04AM 25 to make sure we only ask for interviews in areas that

11:38:07AM 1 continue to remain open. Resolution could have narrowed
11:38:10AM 2 the areas, and it could have limited the topics that we
11:38:13AM 3 needed to interview people on. Once resolution talks
11:38:16AM 4 broke down entirely -- Which the first time that
11:38:20AM 5 Microsoft told us unequivocally that they didn't want to
11:38:23AM 6 talk to us anymore was in July. Up until that time there
11:38:26AM 7 were still some topics that were on the table that could
11:38:29AM 8 have been resolved. Once that happened, we had to do a,
11:38:32AM 9 "Look, what are all the open questions? What are open
11:38:34AM 10 topics? Who do we need to talk to to get to the right
11:38:38AM 11 number?"

11:38:38AM 12 Q. So it was after the resolution talks irrevocably
11:38:44AM 13 broke down, which you say was July, that's when you made
11:38:47AM 14 the decision "Now we need to make these under oath and
11:38:54AM 15 transcribed"?

11:38:55AM 16 MR. WEAVER: Objection. Mischaracterizes --

11:38:56AM 17 THE COURT: I think he answered that. The
11:38:58AM 18 objection will be sustained.

11:38:59AM 19 MR. BECK: Well, we apparently heard it
11:39:01AM 20 differently, because I thought the answer was yes, and he
11:39:03AM 21 said I mischaracterized it.

11:39:07AM 22 THE COURT: What he answered, according to our
11:39:10AM 23 transcript, was that the decision had been made earlier.
11:39:15AM 24 Once resolution talks broke down, that narrowed the areas
11:39:21AM 25 in terms of what they needed to actually focus on, but the

11:39:25AM 1 decision to do interviews, and do those under oath, had
11:39:27AM 2 been made earlier. That's what I understood Mr. Hoory to
11:39:31AM 3 have said.

11:39:32AM 4 **Mr. Beck:**

11:39:33AM 5 Q. Is that your sworn testimony, that before --

11:39:34AM 6 A. Let me clarify clearly, because I think it is a
11:39:37AM 7 little in between the two. The decision that if we had
11:39:39AM 8 unresolved issues, that we would have to pursue
11:39:41AM 9 interviews, and ask which ones to interview and that they
11:39:44AM 10 would be under oath, that was something that was on the
11:39:46AM 11 table that we discussed with the company long before we
11:39:49AM 12 actually asked for the interviewees. And that was long
11:39:52AM 13 before July, when they said, "We are not interested in
11:39:55AM 14 talking with you on any subjects whatsoever."

11:39:57AM 15 So when I say there was a decision to pursue under
11:39:59AM 16 oath interviews on any topics that were material, and that
11:40:08AM 17 we were not resolved, that concept, that goal existed and
11:40:13AM 18 was shared with the company. Certainly I told Mr. Bernard
11:40:16AM 19 the possibility way back in 2012. But certainly in
11:40:20AM 20 February, when Mr. Sample initially said he didn't want to
11:40:23AM 21 engage in all issues, and then certainly throughout the
11:40:25AM 22 spring when we were still trying to figure out what we
11:40:28AM 23 could still talk about.

11:40:29AM 24 Once they said, "We don't want to talk about
11:40:31AM 25 anything," that's when it made sense for us to shift gears

11:40:35AM 1 from trying to resolve one or more open topics and say,
11:40:38AM 2 "Okay, well, we have this whole bucket of topics that we
11:40:41AM 3 identified in January. You don't want to talk about any
11:40:43AM 4 of them, so now we have to go out and do interviews." And
11:40:46AM 5 just like we told the company consistently through the
11:40:49AM 6 spring on all those unresolved items, we anticipated
11:40:52AM 7 that if we identified people that could speak to them,
11:40:54AM 8 that they would be under oath.

11:40:56AM 9 Q. And one of your goals in putting people under oath
11:41:00AM 10 and having the testimony transcribed in the fall of 2014,
11:41:06AM 11 after the resolution talks had broken down, was to create
11:41:10AM 12 a record that Quinn Emanuel could use in the tax court,
11:41:13AM 13 right?

11:41:14AM 14 A. Our goal was to create a record that would reliably
11:41:19AM 15 document the facts upon which we based the decision we
11:41:21AM 16 were still working on to get to the right number.
11:41:24AM 17 Obviously that record would help if the case went to tax
11:41:28AM 18 court.

11:41:29AM 19 Q. Now, are you aware, just as a factual matter, whether
11:41:35AM 20 the tax court routinely allows pretrial discovery?

11:41:42AM 21 A. I am not.

11:41:45AM 22 Q. You don't know one way or another whether it is hard
11:41:48AM 23 to get discovery in the tax court?

11:41:51AM 24 A. I don't have any --

11:41:53AM 25 MR. WEAVER: Asked and answered.

11:41:54AM 1 THE COURT: I think he answered it, counsel.

11:41:56AM 2 Mr. Beck:

11:41:57AM 3 Q. Are you familiar with the tax court rules?

11:41:59AM 4 A. I have never litigated in tax court, no.

11:42:02AM 5 Q. Have you ever talked with anybody at the IRS about

11:42:06AM 6 how difficult it is to get discovery in the tax court?

11:42:13AM 7 A. To the extent I have talked about tax court

11:42:17AM 8 procedure, it has been seeking legal advice from IRS

11:42:22AM 9 counsel.

11:42:22AM 10 Q. I want to talk about the temporary regulation, which

11:42:55AM 11 I think you agreed you told Microsoft was the authority

11:42:57AM 12 for Quinn Emanuel and others to take testimony -- sworn

11:43:06AM 13 testimony in these interviews. Because it was a temporary

11:43:16AM 14 regulation rather than a final regulation, were you able

11:43:22AM 15 to pass this or adopt it without the kind of notice and

11:43:27AM 16 comment period that normally would be required?

11:43:30AM 17 MR. WEAVER: Objection, your Honor. This gets

11:43:31AM 18 into regulatory procedure. Mr. Hoory is not here as any

11:43:37AM 19 sort of regulatory expert. The question isn't directed to

11:43:41AM 20 his experience in the Microsoft audit.

11:43:44AM 21 MR. BECK: Your Honor, we are the ones who asked

11:43:46AM 22 him to come here. They didn't decide what the scope of

11:43:48AM 23 his testimony would be. He was involved in decisions

11:43:54AM 24 concerning the adoption of this temporary regulation, and

11:44:00AM 25 whether that was abusive or legitimate is one of the

11:44:05AM 1 issues in the case. I am asking him factual questions.

11:44:08AM 2 THE COURT: You are not asking him as an expert,
11:44:11AM 3 you're asking him --

11:44:11AM 4 MR. BECK: Yeah, I am asking him factual
11:44:13AM 5 questions.

11:44:13AM 6 THE COURT: The objection will be overruled. Why
11:44:15AM 7 don't you rephrase the question for Mr. Hoory?

11:44:17AM 8 MR. BECK: Sure.

11:44:18AM 9 By Mr. Beck:

11:44:19AM 10 Q. What you understood in your role there at the
11:44:26AM 11 transfer pricing organization is that one effect of
11:44:34AM 12 adopting a temporary regulation instead of a final
11:44:38AM 13 regulation is that you didn't have to give notice to the
11:44:43AM 14 public and give people an opportunity to comment before it
11:44:47AM 15 went into effect, right?

11:44:49AM 16 A. Let me be clear. I didn't -- I certainly don't
11:44:53AM 17 recall having any conversations about what kind of
11:44:56AM 18 regulation was going to be issued. To the extent I had
11:45:01AM 19 involvement with the reg, it was an opportunity to provide
11:45:06AM 20 comments on the substantive wording, not the procedural
11:45:10AM 21 pieces.

11:45:10AM 22 Q. You didn't know that it was going to be a temporary
11:45:13AM 23 regulation?

11:45:14AM 24 A. I don't recall focusing on that particular issue. It
11:45:17AM 25 is possible that I may have noticed that it had a T next

11:45:20AM 1 to it at some point in time. But that was not an issue
11:45:23AM 2 that I focused on personally.

11:45:24AM 3 Q. Well, if it didn't have a T next to it, you wouldn't
11:45:28AM 4 have been able to rely on it when you wrote Microsoft and
11:45:31AM 5 said, "Here is the justification for Quinn Emanuel to be
11:45:36AM 6 participating in these sworn depositions," right?

11:45:40AM 7 A. I honestly don't know. I am not an expert. And I
11:45:44AM 8 don't specialize in the process of promulgating
11:45:48AM 9 regulations.

11:45:49AM 10 Q. You don't know the difference between a temporary and
11:45:52AM 11 a final regulation?

11:45:53AM 12 A. One of the differences I do know, as an example, is I
11:45:56AM 13 think temporary regs expire in two years. But I don't
11:46:01AM 14 know exactly what the differences are between a -- I know
11:46:06AM 15 a regulation is permanent and a temporary regulation is
11:46:10AM 16 temporary. I know there are different procedures. I
11:46:13AM 17 don't know what they are. I haven't had a reason in my
11:46:15AM 18 practice to research the difference between the two. I
11:46:17AM 19 don't know.

11:46:17AM 20 Q. And your sworn testimony is you don't know that when
11:46:22AM 21 there is a temporary regulation that is adopted, the IRS
11:46:29AM 22 doesn't have to follow the normal notice and comment
11:46:32AM 23 procedures? That's your sworn testimony?

11:46:36AM 24 MR. WEAVER: Asked and answered, your Honor.

11:46:37AM 25 THE COURT: The objection will be sustained. Next

11:46:40AM 1 question, Mr. Beck.

11:46:42AM 2 By Mr. Beck:

11:46:43AM 3 Q. If we get discovery and we can talk to people at the
11:46:46AM 4 IRS, is there anybody, other than getting legal advice,
11:46:50AM 5 that you have ever talked to about this temporary
11:46:57AM 6 regulation?

11:46:57AM 7 A. I think there is one of the exhibits that I am
11:47:03AM 8 familiar with that you will see I provided some comments
11:47:05AM 9 on a green sheet circulation. Certainly therein you will
11:47:08AM 10 see the persons to whom I sent those comments. If I
11:47:14AM 11 recall correctly, there was Howard Berger and Tom Ralph.
11:47:19AM 12 They are colleagues of mine in the transfer pricing
11:47:23AM 13 practice or in the TPO. One is in TPO, one is in transfer
11:47:26AM 14 pricing practice, or TPP. They are the persons, it is my
11:47:31AM 15 understanding that -- their case is that the reg project
11:47:35AM 16 originated from, at least of the need for it originated
11:47:37AM 17 from. I think on that email chain was Sam Maruca, my
11:47:43AM 18 boss, who was obviously interested in the use of experts.
11:47:43AM 19 And Tom Vidano is the other person I recall.

11:47:47AM 20 Q. And those are names on an email chain. My question
11:47:50AM 21 is, did you talk to them orally or anybody else at the IRS
11:47:56AM 22 orally about this temporary regulation?

11:47:59AM 23 A. Yes.

11:48:00AM 24 Q. Who?

11:48:00AM 25 A. Those same people.

11:48:03AM 1 Q. You talked to them, had conversations with them about
11:48:06AM 2 the temporary regulation?

11:48:08AM 3 A. I remember having conversations with them after the
11:48:12AM 4 reg was issued. Because -- When the green sheet got
11:48:16AM 5 circulated, I don't recall actually discussing it with
11:48:18AM 6 them. I recall sending and exchanging email
11:48:22AM 7 communications.

11:48:22AM 8 Q. When did you first become aware that this temporary
11:48:25AM 9 regulation was in the works?

11:48:27AM 10 A. I did not learn that the temporary project had
11:48:34AM 11 started or that a reg project had started, because I
11:48:38AM 12 didn't know what variety it was at the time. So I didn't
11:48:40AM 13 learn about the reg project, to the best of my
11:48:43AM 14 recollection, until sometime in the spring of 2014. I had
11:48:47AM 15 previously, in 2013, learned about the issue -- just the
11:48:52AM 16 issue about whether experts could participate or not in
11:48:57AM 17 summons interviews, because Mr. Ralph and Mr. Berger had
11:49:01AM 18 brought it to my attention when it arose in their case.
11:49:04AM 19 But at that point in time, to the best of my knowledge,
11:49:06AM 20 there was no reg project.

11:49:08AM 21 I learned about the issue that the reg was addressing
11:49:11AM 22 and clarifying in 2013. I don't recall learning about --
11:49:16AM 23 that a reg project had started until sometime in 2014.

11:49:19AM 24 Q. Tell me what they told you in 2013 about how this
11:49:22AM 25 issue had arisen. What did they tell you?

11:49:26AM 1 A. So Tom Ralph, he was the central manager for the
11:49:31AM 2 transfer pricing practice. He has a large, I guess -- not
11:49:36AM 3 docket, but number of cases that he supports in transfer
11:49:40AM 4 pricing. Howard Berger. He was a colleague of mine in
11:49:44AM 5 the transfer pricing operation. Just like I do, he
11:49:48AM 6 supported local teams. In this case he was supporting
11:49:50AM 7 Mr. Ralph's. There, my understanding is, from
11:49:52AM 8 conversations with them, that they had an outside expert.
11:49:57AM 9 I don't know the exact variety, but my impression was that
11:50:02AM 10 it was an economist. And whatever variety of expert it
11:50:06AM 11 was, they had wanted to schedule some interviews with the
11:50:10AM 12 taxpayer, to speak to taxpayer employees, just like we are
11:50:15AM 13 trying to do in the Microsoft case a couple of years
11:50:18AM 14 later.

11:50:20AM 15 When they said that their expert would be there, the
11:50:24AM 16 taxpayer objected. At that point in time Mr. Ralph and
11:50:28AM 17 Mr. Berger reached out to their colleagues in transfer
11:50:31AM 18 pricing, so I can remember them reaching out to myself,
11:50:35AM 19 Mr. Maruca, and said, "Hey, we have never seen this. Have
11:50:39AM 20 you seen this?" In our collective experience -- not so
11:50:42AM 21 much me, but if you add my colleagues' experience
11:50:45AM 22 together, that is multiple decades. Between the four of
11:50:48AM 23 us we probably have about 80 years. We were all
11:50:50AM 24 flabbergasted and surprised. We thought that is a
11:50:53AM 25 creative argument, but one no one ever expected. At least

11:50:56AM 1 from our perspectives, we had always assumed that the IRS,
11:51:00AM 2 when it hired experts, that they could ask questions; and
11:51:02AM 3 if those questions are in the format of a summons
11:51:06AM 4 interview, that there was no issue, just like we share
11:51:08AM 5 with experts documents day in and day out so they can
11:51:11AM 6 assist us with their analyses.

11:51:13AM 7 Q. This interview that they told you about, was this an
11:51:17AM 8 interview where a witness was put under oath and the
11:51:20AM 9 questions and answers were transcribed?

11:51:23AM 10 A. It is my understanding that is what they were
11:51:26AM 11 seeking, that's correct.

11:51:27AM 12 Q. And then was your understanding that this entire
11:51:31AM 13 temporary regulation project was geared toward creating
11:51:37AM 14 some authority that you could rely on for allowing outside
11:51:43AM 15 experts or contractors to participate in sworn interviews?

11:51:52AM 16 A. I wouldn't characterize it that way. It is close,
11:51:55AM 17 but not exact. It is my understanding that that initial
11:51:58AM 18 identification of this issue, which surprised all of us,
11:52:02AM 19 didn't make sense to the IRS, and wasn't consistent with
11:52:05AM 20 our understanding of how we could and do use experts.

11:52:08AM 21 And that at some point in time -- and there was a long
11:52:11AM 22 period of time where I didn't hear anything about it, but
11:52:13AM 23 at some point in time someone was presumably working on
11:52:16AM 24 this or thinking about this. At some point in time in
11:52:19AM 25 2014 I became aware of this reg project, to clarify and

11:52:23AM 1 make clear what the IRS thought and what its position was
11:52:26AM 2 at the time, that our experts are there to help us, they
11:52:29AM 3 are there to look at books and records, and when we do
11:52:32AM 4 interviews they are there to help us ask intelligent
11:52:35AM 5 questions. We wanted to make sure they were able to do
11:52:38AM 6 so.

11:52:38AM 7 Q. In your collective 70 or 80 years of experience,
11:52:41AM 8 whatever it was that you mentioned before, had any of you
11:52:48AM 9 ever been involved in a situation where instead of an
11:52:52AM 10 economist or an engineer or an accountant, some sort of
11:52:59AM 11 expert like that, instead of that the IRS had hired
11:53:04AM 12 outside counsel to act as consultants, and for the outside
11:53:13AM 13 counsel to be asking questions of witnesses when they are
11:53:19AM 14 under oath and being transcribed?

11:53:22AM 15 A. I can't speak to my colleagues' experience --

11:53:26AM 16 Q. Just yours then.

11:53:27AM 17 A. My own. I am aware of cases where the IRS has hired
11:53:32AM 18 outside counsel to advise. I am not aware of cases where
11:53:34AM 19 they have invited counsel to do under-oath interviews.

11:53:39AM 20 Q. So far as you know, nobody else had ever done that,
11:53:44AM 21 right?

11:53:45AM 22 A. As far as I know, with respect to the outside
11:53:49AM 23 counsel.

11:53:49AM 24 Q. Right, right, the outside counsel. As far as you
11:53:52AM 25 know, the first time in the history of the universe that

11:53:55AM 1 anybody from the IRS said that outside counsel should be
11:54:02AM 2 allowed to participate as experts or contractors in
11:54:08AM 3 conducting sworn testimony, the first time in the history
11:54:11AM 4 of the universe was when you did it with Quinn Emanuel in
11:54:17AM 5 the fall of 2014, right?

11:54:19AM 6 A. That is the first instance that I am aware of. I
11:54:22AM 7 guess I am a trailblazer.

11:54:24AM 8 Q. And planning to do this, and be this trailblazer, you
11:54:37AM 9 say you weren't tracking closely what was going on with
11:54:40AM 10 this regulation project?

11:54:42AM 11 A. Give me one moment, please. I wasn't aware of the
11:54:52AM 12 reg project until the spring of 2014, as I mentioned. I
11:54:56AM 13 don't know when it started.

11:54:58AM 14 Q. I would like to shift gears here to what was
11:55:22AM 15 happening during the audit.

11:55:24AM 16 THE COURT: Counsel, if we are going to shift
11:55:27AM 17 gears here, we are about five minutes before noon, let's
11:55:30AM 18 go ahead and break for our noon recess. If we could have
11:55:33AM 19 everybody back at ten minutes after 1:00, and then we will
11:55:37AM 20 do our best to start up at 1:15, and hopefully have
11:55:41AM 21 everybody here. We will be in recess.

01:15:05PM 22 (Lunch break.)

01:15:05PM 23 THE COURT: Counsel, before we get started, I am a
01:15:08PM 24 little bit concerned about the pacing of how we are going
01:15:11PM 25 today. Mr. Weaver, let me ask you, how much time does the

01:15:14PM 1 IRS feel that they need for their presentation?

01:15:18PM 2 MR. WEAVER: Your Honor, I appreciate that. We
01:15:20PM 3 are going to need an hour and 15 minutes to an hour and a
01:15:23PM 4 half to lay out what I laid out in my opening. We need
01:15:27PM 5 that much time.

01:15:28PM 6 THE COURT: Mr. Beck, what that means is, we have
01:15:30PM 7 about two and a half hours left in the afternoon, once we
01:15:33PM 8 factor in our break for our court reporter. You have
01:15:37PM 9 about an hour, counsel.

01:15:39PM 10 MR. BECK: Thank you, sir. I would just ask if
01:15:44PM 11 perhaps the court could request Mr. Hoory, once again, to
01:15:47PM 12 try to keep his answers short and responsive. That would
01:15:51PM 13 help me get through as much as I can.

01:15:53PM 14 THE COURT: Mr. Hoory, I would ask -- and I have
01:15:56PM 15 asked this before, just do your best to answer the
01:15:59PM 16 question. All of the legal arguments will be made at a
01:16:03PM 17 later point in time. The interpretations of statutes will
01:16:07PM 18 be something the court does. So from you we just need the
01:16:11PM 19 facts. All right?

01:16:12PM 20 THE WITNESS: I understand, your Honor.

01:16:14PM 21 THE COURT: You may inquire.

01:16:16PM 22 By Mr. Beck:

01:16:16PM 23 Q. Mr. Hoory, I think you mentioned before the break
01:16:19PM 24 that you commented at some point on the temporary
01:16:24PM 25 regulation?

01:16:26PM 1 **A.** I commented on the green sheet circulation. It
01:16:30PM 2 wasn't a temp reg -- Are you talking about before or
01:16:33PM 3 after, is what I am asking?
01:16:35PM 4 **Q.** Did you ever comment on what became the temporary
01:16:38PM 5 regulation?
01:16:39PM 6 **A.** I discussed the regs after they were promulgated,
01:16:43PM 7 yes.
01:16:44PM 8 **Q.** Didn't you comment before the regulation was adopted?
01:16:50PM 9 **A.** If you mean the input I had into the language, that
01:16:55PM 10 was obviously before it was adopted. If you mean have I
01:16:57PM 11 ever mentioned the regulation after it was adopted,
01:17:00PM 12 obviously I have.
01:17:01PM 13 **Q.** No, no, no. You had input before the regulation was
01:17:05PM 14 adopted, and you wrote a comment, right?
01:17:07PM 15 **A.** Correct.
01:17:08PM 16 **Q.** Now, I want to show you Exhibit 130. This is what
01:17:20PM 17 was produced to us in response to our FOIA request. On
01:17:28PM 18 here somewhere is there an email that is your -- transmits
01:17:34PM 19 your comment?
01:17:35PM 20 **A.** I think you will have to scroll down a page or two,
01:17:37PM 21 if this is the email that I am aware of.
01:17:41PM 22 **Q.** Here we go, on Page 2. What we got in response to
01:17:49PM 23 our FOIA request was from Eli Hoory to various people,
01:17:59PM 24 "Re: Green sheet circulation." And I don't want to spend
01:18:02PM 25 the time to talk about the green sheet, what that means

01:18:05PM 1 exactly, but it is an opportunity for you to comment
01:18:09PM 2 before a regulation is promulgated, right?

01:18:12PM 3 A. That's right. In a fairly late stage, yes.

01:18:15PM 4 Q. And the question -- the subject that you wrote is,
01:18:22PM 5 "7602." Again, without getting into the substance, that
01:18:27PM 6 is the statutory provision that says that the secretary or
01:18:31PM 7 the secretary's delegates are allowed to take sworn
01:18:35PM 8 testimony, right?

01:18:36PM 9 A. Right. But I didn't write that subject. I just
01:18:39PM 10 replied to an email.

01:18:41PM 11 Q. You were replying to an email saying that. And the
01:18:45PM 12 email says, "Urgent." And then this "importance high,"
01:18:50PM 13 was that something that you put on there or was that sent
01:18:54PM 14 to you?

01:18:54PM 15 A. I don't recall. I can't tell you that every green
01:18:59PM 16 sheet I have ever received says "urgent" next to it.
01:19:02PM 17 Depending upon what your settings are -- sometimes we
01:19:04PM 18 applied them -- I don't know if it was me or them,
01:19:05PM 19 honestly.

01:19:06PM 20 Q. Then what we were given was, "Tom," and then
01:19:12PM 21 everything else is blacked out?

01:19:14PM 22 A. Up to, "Thanks for your consideration," yes.

01:19:15PM 23 Q. I'm sorry? What?

01:19:17PM 24 A. Yes. Up to the bottom, yes.

01:19:19PM 25 Q. I guess there is something that says "thanks" or

01:19:22PM 1 something at the bottom. I can't read that part.

01:19:25PM 2 Did you have anything to do with the decision to
01:19:31PM 3 black out your email?

01:19:33PM 4 A. I did not.

01:19:33PM 5 Q. So then recently -- Let me show you Exhibit 130-1.

01:19:53PM 6 So recently somebody made a decision to unredact this

01:19:59PM 7 email and to produce it to us in connection with this

01:20:04PM 8 lawsuit. Have you seen this unredacted version in the

01:20:08PM 9 last couple of weeks?

01:20:09PM 10 A. I have. I saw it this week.

01:20:11PM 11 Q. In connection with preparing for your testimony,
01:20:14PM 12 right?

01:20:15PM 13 A. Correct.

01:20:16PM 14 Q. Did you have any role in deciding, notwithstanding
01:20:25PM 15 the claim of deliberative process, that the IRS was going
01:20:28PM 16 to waive deliberative process when it came to your
01:20:31PM 17 comments on the regulation?

01:20:33PM 18 A. I'm not sure if I can answer the back and forth of
01:20:39PM 19 counsel.

01:20:39PM 20 THE COURT: Do you understand the question?

01:20:41PM 21 THE WITNESS: I understand the question. I will
01:20:42PM 22 ask --

01:20:43PM 23 MR. WEAVER: To the extent that there was any
01:20:45PM 24 discussion with counsel, we are asserting privilege.

01:20:49PM 25 THE COURT: You are just looking -- Let me have

01:20:52PM 1 you ask for a specific --

01:20:55PM 2 MR. BECK: I am not asking for the substance of
01:20:57PM 3 any conversations that he had with counsel. I am asking
01:21:00PM 4 whether he had any role in the decision to waive the
01:21:05PM 5 deliberative process privilege insofar as it related to
01:21:09PM 6 his comments on this regulation.

01:21:15PM 7 THE COURT: You can answer yes or no.

01:21:16PM 8 THE WITNESS: Basically, yes. I did interpret the
01:21:20PM 9 deliberative process or how it applied, but I commented on
01:21:25PM 10 whether it made sense to unredact or redact.

01:21:28PM 11 By Mr. Beck:

01:21:28PM 12 Q. You wanted this unredacted?

01:21:29PM 13 A. I was in favor of it, personally.

01:21:32PM 14 Q. You thought if you waived the deliberative process as
01:21:37PM 15 to this particular document, that would help the IRS's
01:21:40PM 16 case, right?

01:21:42PM 17 A. I thought it would allow you and the court to see
01:21:44PM 18 what I wrote and assess the content.

01:21:47PM 19 Q. And you thought it would help the IRS's cause if you
01:21:52PM 20 waived the deliberative process as to your comments, even
01:21:57PM 21 though they are maintaining it as to everybody else's,
01:22:00PM 22 right?

01:22:00PM 23 A. I honestly don't know whether it would help or not.
01:22:04PM 24 I think it gives the court information that they wouldn't
01:22:06PM 25 have otherwise had. If it is helpful for us, it helps us.

01:22:10PM 1 **If the court determines it is not, it is not going to help**
01:22:13PM 2 **us. I thought it made sense to lay it out and let the**
01:22:16PM 3 **court decide.**

01:22:17PM 4 **Q. Is there some reason why it makes sense to lay it all**
01:22:22PM 5 **out and let the court decide based on all the facts when**
01:22:27PM 6 **it comes to your comments, but not as to everybody else's?**

01:22:32PM 7 **A. I don't know what other persons' comments are, so I**
01:22:34PM 8 **can't really evaluate that.**

01:22:36PM 9 **Q. Well, if you think that the right thing to do is to**
01:22:40PM 10 **let the chips fall where they may, whether it is helpful**
01:22:43PM 11 **or not helpful, just so the judge has all the information**
01:22:47PM 12 **as to your comments, wouldn't that apply as to everybody**
01:22:51PM 13 **else's comments?**

01:22:53PM 14 **A. I imagine it depends upon the content and whether it**
01:22:56PM 15 **is covered by privilege.**

01:22:57PM 16 **Q. Well, yours were covered by privilege, but you said**
01:23:00PM 17 **you wanted it unredacted so the judge would have the full**
01:23:04PM 18 **story, right?**

01:23:05PM 19 **A. This is something I wrote -- To the extent I made**
01:23:11PM 20 **some comments and they are relevant to the matters at**
01:23:15PM 21 **issue, I would like to know whether or not they are**
01:23:18PM 22 **helpful or hurtful. You know, just get it out of the way**
01:23:20PM 23 **and I can move on with my life and the examination. Yes,**
01:23:24PM 24 **I wanted them out.**

01:23:31PM 25 **Q. Now, in your comments over on Page 2, where we see**

01:23:41PM 1 the unredacted version -- And I am going to try to see if
01:23:48PM 2 I can summarize and shorten it up a little bit. As I
01:23:52PM 3 understand the substance of your comment, you were
01:23:55PM 4 suggesting that a dependent clause be moved within the
01:24:00PM 5 language of the regulation, because as it was written
01:24:04PM 6 somebody could interpret it to mean that experts couldn't
01:24:10PM 7 even look at documents unless they were under the
01:24:13PM 8 supervision of the -- direct supervision of the IRS, and
01:24:18PM 9 you wanted to make sure that clause removed -- was moved
01:24:24PM 10 so that people understood that experts could look at
01:24:27PM 11 documents on their own, but they couldn't take testimony
01:24:31PM 12 unless they were under the supervision of the IRS?
01:24:34PM 13 A. Yeah, that is basically it. I was supporting what we
01:24:37PM 14 understood the status quo to be.
01:24:39PM 15 Q. And, of course, one of the experts you had in mind
01:24:42PM 16 that would be covered by this was Quinn Emanuel, right?
01:24:45PM 17 A. Together with every other expert --
01:24:48PM 18 Q. I said one of the experts was Quinn Emanuel, right?
01:24:51PM 19 A. Yes, together with every other expert the IRS hires.
01:24:54PM 20 Q. You didn't want anybody to think that when Quinn
01:24:57PM 21 Emanuel is going over our confidential taxpayer
01:24:59PM 22 information, that they should have to be under the
01:25:02PM 23 supervision of the IRS, right?
01:25:04PM 24 A. I didn't think they would have to be in the presence
01:25:07PM 25 of the IRS. Obviously, they are always working for us,

01:25:10PM 1 and they are always supervised by a COR, contracting
01:25:15PM 2 officer's representative, and the POC, the point of
01:25:17PM 3 contract, or a contracting officer. So I didn't think we
01:25:20PM 4 needed to be physically present when they were looking at
01:25:24PM 5 documents.

01:25:25PM 6 Q. In fact, you gave them, didn't you, computers that
01:25:29PM 7 had like all of our documents on them? And you gave Quinn
01:25:32PM 8 Emanuel special computers that were loaded up with all of
01:25:35PM 9 the confidential information that we turned over over
01:25:39PM 10 eight years in this audit process, right?

01:25:41PM 11 A. That is actually inaccurate. We gave them laptops at
01:25:45PM 12 some point. I don't think we had anything preloaded on
01:25:48PM 13 them. The reason we gave them to them is because the IRS
01:25:51PM 14 computers allow for secure communications. So it was
01:25:54PM 15 actually to protect the information better, not vice
01:25:57PM 16 versa.

01:25:57PM 17 Q. Well, these computers, did they have access to the
01:26:01PM 18 servers where all of our confidential information is kept?

01:26:06PM 19 A. I honestly don't know.

01:26:08PM 20 Q. Well, how were they going to review all of our stuff
01:26:12PM 21 unless they had access to it on their computers?

01:26:14PM 22 A. We gave it to them on secure removable media
01:26:17PM 23 originally, encrypted in accordance with the Federal
01:26:19PM 24 Information Protection Standards.

01:26:19PM 25 Q. And then they put that stuff on their computers,

01:26:22PM 1 right?

01:26:22PM 2 A. Are you talking about the laptops? I don't know
01:26:25PM 3 where they put them, honestly.

01:26:27PM 4 Q. I want to focus actually not so much on your wanting
01:26:31PM 5 to move the clause around as -- introductory statement
01:26:38PM 6 here. I think you testified that this was the only time
01:26:45PM 7 you commented on the reg, right?

01:26:46PM 8 A. I didn't say that this was. I said this instance is
01:26:49PM 9 what I am talking about. What I am referring to here,
01:26:52PM 10 "One final comment," is there were some exchanges. There
01:26:55PM 11 is other people on this email, including Howard Berger and
01:26:59PM 12 Tom Ralph, who I referred to earlier. They had some
01:27:02PM 13 comments previously. I don't know if it was in this email
01:27:04PM 14 chain or a different one, because we could send things in
01:27:07PM 15 differently. In other words, you could get the same email
01:27:10PM 16 reply to it, and Mr. Weaver could reply to the same email
01:27:14PM 17 separately. What I was referring to in, "One more
01:27:18PM 18 comment" was Mr. Berger and Mr. Ralph had made some prior
01:27:22PM 19 comments, I was adding one additional one.

01:27:25PM 20 Q. You say, "One final comment/suggestion." You had no
01:27:31PM 21 idea somebody was going to comment after you?

01:27:33PM 22 A. I am speaking for myself. This is my last comment.

01:27:36PM 23 Q. Your last comment. What I want to know is -- Here
01:27:39PM 24 you have transmitted your last comment. I want to know
01:27:42PM 25 about your earlier comments.

01:27:44PM 1 **A.** So, as I mentioned, Mr. Berger and Mr. Ralph had some
01:27:49PM 2 comments previously. I do -- I don't recall -- I
01:27:52PM 3 remember Mr. Ralph's had to do with the effective date and
01:27:57PM 4 timing, and I remember Mr. Berger's was substantive,
01:28:03PM 5 something stylistic. I don't remember what they were.
01:28:04PM 6 The only thing I remember prior to this email was me
01:28:08PM 7 seconding Howard's suggestions as things that made sense.
01:28:12PM 8 **Q.** Where is that? We haven't seen any other emails from
01:28:15PM 9 you at all commenting on the regulation. You mean there
01:28:18PM 10 are other emails and we just haven't been given them?
01:28:21PM 11 **A.** I don't know what you have been given or not.
01:28:23PM 12 **Q.** I can represent to you that we don't have any other
01:28:25PM 13 emails from you commenting on --
01:28:27PM 14 **A.** I can tell you -- I don't know at what stage it was,
01:28:30PM 15 but I can tell you that I hit reply at some point with
01:28:35PM 16 regards to comments that either Mr. Ralph or Mr. Berger
01:28:39PM 17 made at some point with respect to this regulation.
01:28:42PM 18 **Q.** Would you agree --
01:28:43PM 19 **A.** I think it was all within like a day or two,
01:28:46PM 20 honestly. I don't know the exact time, though.
01:28:47PM 21 **Q.** Do you agree that wherever this email is, where you
01:28:52PM 22 hit reply, and then another comment, that we ought to be
01:28:57PM 23 able to look at that, too?
01:28:58PM 24 **A.** I honestly don't care one way or another. I will
01:29:02PM 25 leave that to IRS counsel to determine what is or isn't

01:29:05PM 1 **privileged.**

01:29:05PM 2 **Q. Well, didn't you already decide that your comments --**
01:29:14PM 3 **you are going to waive the deliberative process privilege?**

01:29:17PM 4 **Are you saying you decided to --**

01:29:19PM 5 **A. I don't make the decision --**

01:29:20PM 6 **Q. -- waive it as to one, but not waive it as to others?**

01:29:24PM 7 **A. I don't make the decision on what gets waived and**
01:29:26PM 8 **what isn't.**

01:29:27PM 9 **Q. You participated in it, though? You just said so,**
01:29:29PM 10 **right?**

01:29:29PM 11 **A. Only with respect to this email.**

01:29:30PM 12 **Q. So you are saying, as far as you are concerned, you**
01:29:34PM 13 **wanted the judge to have the full story, but only as to**
01:29:37PM 14 **this email. For other emails from you, you want to leave**
01:29:40PM 15 **it up to counsel to decide, right?**

01:29:42PM 16 **A. At the end of the day, IRS counsel or the P&A folks,**
01:29:47PM 17 **they determine what is privileged or not. This is the one**
01:29:49PM 18 **we discussed, because my understanding is it is what made**
01:29:53PM 19 **it to the administrative file. Other things -- I don't**
01:29:55PM 20 **know what is in or out. I don't make those**
01:29:58PM 21 **determinations.**

01:29:59PM 22 **Q. I want to talk now about some things that happened**
01:30:21PM 23 **during the audit. You indicated, I think, that you joined**
01:30:30PM 24 **the TPO -- what was it, November of 2011?**

01:30:34PM 25 **A. I think it was October -- The first time I was**

01:30:37PM 1 involved in the Microsoft audit was November.

01:30:41PM 2 Q. So within a month of joining the TPO. Did you come
01:30:45PM 3 directly from Covington & Burling?

01:30:47PM 4 A. I did.

01:30:48PM 5 Q. Within a month you were involved in the Microsoft
01:30:51PM 6 audit, right?

01:30:52PM 7 A. Initially at a very high level as an audience. Over
01:30:55PM 8 time I came to be more involved, yes.

01:30:58PM 9 Q. In fact, you not only became more involved, you are
01:31:01PM 10 in charge of the Microsoft audit now, right?

01:31:02PM 11 A. I wouldn't say that. I would say that I take the
01:31:05PM 12 lead with respect to the transfer pricing issues.

01:31:09PM 13 Q. Okay. Fine. The subject matter we have been
01:31:10PM 14 focusing on, transfer pricing issues, you have taken the
01:31:16PM 15 lead on that on behalf of the TPO, right?

01:31:18PM 16 A. Certainly.

01:31:19PM 17 Q. Now, does the TPO have a roadmap -- a general roadmap
01:31:26PM 18 that they follow in transfer pricing audits?

01:31:31PM 19 A. So as part of standing up TPO, they worked on,
01:31:35PM 20 basically, procedures. They are not one-size-fits-all.
01:31:42PM 21 There are some goals and things to think about. But, yes,
01:31:44PM 22 there was a roadmap that was developed. I think it was
01:31:47PM 23 published sometime in 2014.

01:31:48PM 24 Q. Is Exhibit 136 the roadmap?

01:31:51PM 25 A. Looks right to me.

01:31:53PM 1 Q. And the introductory paragraph here -- Did you have
01:32:01PM 2 input into this roadmap?

01:32:02PM 3 A. Very limited. There were other persons who worked on
01:32:06PM 4 that much closely than I did.

01:32:07PM 5 Q. But you are familiar with it, right?

01:32:09PM 6 A. Broadly. I reviewed it for today.

01:32:11PM 7 Q. I'm sorry?

01:32:11PM 8 A. I said I reviewed it to make sure I was up to speed
01:32:14PM 9 on it for today.

01:32:15PM 10 Q. You reviewed it at the time it came out, or in
01:32:19PM 11 preparation for your testimony?

01:32:20PM 12 A. I reviewed it in preparation for my testimony. At
01:32:24PM 13 the time it came out I had seen an earlier iteration,
01:32:29PM 14 maybe -- probably a year or two before it came out, but I
01:32:33PM 15 wasn't involved at the time it actually got published.

01:32:34PM 16 Q. Okay. But you are up to speed on it for your
01:32:38PM 17 testimony, right?

01:32:38PM 18 A. Certainly.

01:32:39PM 19 Q. So we have this introductory language here. I want
01:32:45PM 20 to move as quickly as I can and focus on the kind of
01:32:52PM 21 time -- the generalized timeline that is on Page 3. And I
01:32:56PM 22 have highlighted here, "Transfer pricing audit stages and
01:33:00PM 23 timeline." And then you, you being the IRS, set forth
01:33:06PM 24 kind of a typical sequence and timeline for the different
01:33:10PM 25 stages of a transfer pricing audit, correct?

01:33:13PM 1 **A.** Yes. But on the first page it basically says there
01:33:17PM 2 is no one-size-fits-all. It says that transfer pricing
01:33:21PM 3 cases are very complex, fact specific, and they typically
01:33:23PM 4 take two to three years or more. So this is just a
01:33:27PM 5 generic sense.

01:33:27PM 6 **Q.** Along the way here, and in other parts of the
01:33:38PM 7 document, do you identify or the IRS identify who should
01:33:42PM 8 be involved at these different stages?

01:33:44PM 9 **A.** I think there is aspirational statements to that
01:33:47PM 10 effect, yes.

01:33:48PM 11 **Q.** Is there any place in this document that you are up
01:33:52PM 12 to speed on where the IRS says, "Here is the point where
01:33:57PM 13 we ought to bring in outside counsel to help us complete
01:34:04PM 14 the audit, or give us a gut check, or get ready to fight
01:34:09PM 15 in the tax court"?

01:34:10PM 16 **A.** I don't think -- It certainly doesn't use the words
01:34:15PM 17 you used.

01:34:15PM 18 **Q.** Well, is there any place anywhere in the document
01:34:18PM 19 that you are up to speed on where the IRS says, "Here is
01:34:24PM 20 the stage to bring in outside counsel, because they can be
01:34:28PM 21 so helpful in these complicated audits"?

01:34:32PM 22 **A.** It talks about who is supposed to be involved. It
01:34:34PM 23 doesn't use the words "outside counsel." It talks about
01:34:36PM 24 evaluating, once you know enough about the basic facts,
01:34:39PM 25 what kind of expertise you need. It talks about bringing

01:34:41PM 1 in internal folks to get up to speed. It talks about
01:34:44PM 2 consulting with IRS counsel. It also talks about
01:34:47PM 3 considering whether or not you should hire outside experts
01:34:49PM 4 as well.

01:34:51PM 5 Q. And you said what kind of expertise ought to be
01:34:55PM 6 involved. And nowhere in this document, that you are up
01:34:58PM 7 to speed on, does the IRS say, "You know what, one area of
01:35:04PM 8 expertise that is really important in these complicated
01:35:08PM 9 transfer pricing cases is commercial litigation
01:35:12PM 10 expertise," right?

01:35:13PM 11 A. It does not use those words anywhere in the document.

01:35:16PM 12 Q. It not only doesn't use those words, it doesn't have
01:35:20PM 13 that concept remotely referred to in the document, does
01:35:23PM 14 it?

01:35:23PM 15 A. This is a generic roadmap --

01:35:26PM 16 Q. And in this generic document --

01:35:27PM 17 THE COURT: Mr. Beck. I'm sorry. You have to
01:35:28PM 18 let --

01:35:29PM 19 By Mr. Beck:

01:35:29PM 20 Q. Go ahead. It is a generic document.

01:35:31PM 21 A. Well, it is a generic roadmap. Every case is
01:35:34PM 22 different. It says that clearly in here. You have to
01:35:37PM 23 consider the facts and circumstances in the case, because
01:35:38PM 24 that's what makes or breaks a transfer pricing audit. We
01:35:42PM 25 also talk about dropping things when we look at them, and

01:35:45PM 1 don't beat the bushes. If you find something, you decide
01:35:48PM 2 what resources you need. It is talking about making
01:35:50PM 3 intelligent decisions. In this case, given its size -- in
01:35:53PM 4 Microsoft's case, given its size and complexity, we
01:35:55PM 5 thought that complex commercial litigation expertise was
01:36:00PM 6 one thing that could add to our resources and make us get
01:36:02PM 7 to a better result, a more reasonable result, and the
01:36:05PM 8 right number.

01:36:05PM 9 Q. This is the kind of answer I was hoping you would
01:36:08PM 10 give me yes or no on. My question was, nowhere in this
01:36:11PM 11 document, that you are up to speed on, is there any hint
01:36:18PM 12 that outside lawyers should be hired, because one of the
01:36:21PM 13 areas of expertise that you claim is so important in an
01:36:25PM 14 audit is commercial litigation, right?

01:36:27PM 15 A. I already told you this does not refer to commercial
01:36:31PM 16 litigators, in my memory.

01:36:33PM 17 Q. Incidentally, Quinn Emanuel -- John Quinn and John
01:36:43PM 18 Gordon, did they have any tax experience in their
01:36:47PM 19 background?

01:36:48PM 20 A. I know that John Gordon has -- represents clients on
01:36:54PM 21 tax matters. I do not know with respect to Mr. Quinn.

01:36:58PM 22 Q. Well, Mr. Gordon never represented anybody on
01:37:01PM 23 transfer pricing issues, did he?

01:37:03PM 24 A. Not to my knowledge.

01:37:05PM 25 Q. Neither Mr. Quinn nor Mr. Gordon, whose expertise you

01:37:12PM 1 say would be so important in working on your audit,
01:37:16PM 2 neither one of them have any experience at all in
01:37:19PM 3 litigating audit questions, have they?
01:37:21PM 4 A. To the extent the audit questions deal with complex
01:37:27PM 5 experts and items of commercial or IP law, which are
01:37:32PM 6 overlapped here since we are talking about intangibles, or
01:37:36PM 7 interpretation of contracts, representation of valuations,
01:37:39PM 8 I think they do have some of that expertise in their
01:37:43PM 9 either intellectual property or antitrust litigation. So
01:37:45PM 10 that was the kind of expertise we were looking to
01:37:47PM 11 supplement. We had very good transfer pricing -- that is,
01:37:51PM 12 the transfer pricing, legal expertise in the IRS.
01:37:53PM 13 Q. My question is, did either of these gentlemen have
01:37:56PM 14 any experience in litigating tax audit issues?
01:38:00PM 15 A. It depends on what your definition of what "tax audit
01:38:03PM 16 issues" is. If you are asking did they have experience
01:38:06PM 17 litigating transfer pricing issues, then my answer is no,
01:38:10PM 18 I don't believe so.
01:38:10PM 19 Q. Now, the timeline here, the generic timeline, talks
01:38:24PM 20 about when you are going to do things like issue IDRs.
01:38:29PM 21 Those are information document requests, right?
01:38:33PM 22 A. Correct.
01:38:34PM 23 Q. And then -- Does it talk about interviews in here
01:38:41PM 24 somewhere?
01:38:42PM 25 A. There is a number of discussions about interviews. I

01:38:46PM 1 think in the early stage they talk about talking to the
01:38:49PM 2 businesspeople. Later on they suggest, you know, thinking
01:38:52PM 3 about whether or not you need to do interviews as well.
01:38:55PM 4 But it is not in here, it is in the meat of the document.
01:38:58PM 5 Q. And then the final stages are resolution discussions,
01:39:02PM 6 and then final NOPA -- This is on the bottom right-hand
01:39:07PM 7 corner. What does that stand for?
01:39:08PM 8 A. Notice of proposed adjustment. So if we are not
01:39:12PM 9 issuing a statutory notice, we typically issue a notice of
01:39:15PM 10 proposed adjustment.
01:39:16PM 11 Q. Would that be like a 30-day letter?
01:39:19PM 12 A. I think it accompanies the 30-day letter, strictly
01:39:22PM 13 speaking.
01:39:23PM 14 Q. And then case closed, right?
01:39:25PM 15 A. No.
01:39:27PM 16 Q. Case closing? That's what it says, right?
01:39:32PM 17 A. "Case closing," that means, you know, at some point
01:39:34PM 18 if exam's finished up their stuff, then either it goes
01:39:38PM 19 from a 30-day letter to a stat notice, or from a 30-day
01:39:41PM 20 letter to appeals.
01:39:42PM 21 There is also a note at the last page about continuing
01:39:45PM 22 reevaluating the timeline. And one of the notes, that
01:39:48PM 23 could happen after this, is, it says, that if the taxpayer
01:39:51PM 24 presents new legal or factual issues, or anything survives
01:39:57PM 25 in the protest, consider pulling the NOPA and reopening

01:40:00PM 1 the case. I think that is in the last page of this
01:40:03PM 2 roadmap.

01:40:03PM 3 Q. Let's take a look at Exhibit 78. Was this a proposed
01:40:13PM 4 timeline concerning the Microsoft audit, dated around
01:40:23PM 5 July 12th, 2012?

01:40:27PM 6 A. Yes. Basically, when we were meeting with Microsoft
01:40:31PM 7 they asked us if there were milestones, and this was the
01:40:33PM 8 first effort to do so.

01:40:36PM 9 Q. And the timeline basically contemplated a total of
01:40:41PM 10 about an additional 16 months until closure, right?

01:40:44PM 11 A. Do you want me to do a map? This is from July
01:40:50PM 12 until --

01:40:50PM 13 Q. Well, we are starting July of 2012 --

01:40:53PM 14 A. It went from the statute extension date.
01:40:57PM 15 October 30th was when the statute was extended to. We
01:41:00PM 16 just worked backwards. We knew that we needed at least
01:41:04PM 17 three months, if we didn't reach resolution, to decide
01:41:06PM 18 whether to issue a 30-day letter or a stat notice. And
01:41:10PM 19 then we just went backwards and tried to fit everything
01:41:13PM 20 else, as best we could, into the remaining time.

01:41:15PM 21 Q. And so it is starting -- Actually, I overstated it.
01:41:19PM 22 Starting in July of 2012, and you are contemplating that
01:41:28PM 23 you can wrap this thing up in about twelve months,
01:41:34PM 24 resolution of issues or issuance of a 30-day letter,
01:41:37PM 25 right?

01:41:38PM 1 **A.** That's what it says. As I mentioned, we just worked
01:41:41PM 2 back from the statute expiration date. We knew we needed
01:41:46PM 3 three months if we had to issue a stat notice. The normal
01:41:48PM 4 course, though, is we don't aspire to issue a stat notice.
01:41:52PM 5 The normal course in every audit is we normally -- just --
01:41:54PM 6 if we have un-agreed issues, we usually do a 30-day
01:41:56PM 7 letter. A stat notice is a future decision that we make
01:42:00PM 8 after developing the facts and seeing what the taxpayer
01:42:02PM 9 does.

01:42:03PM 10 **Q.** You mentioned the statute of limitations date. Is it
01:42:06PM 11 the case, as of July 12th, 2012, Microsoft had agreed to
01:42:12PM 12 an extension of the statute of limitation that would take
01:42:15PM 13 it out to October 30, 2013?

01:42:18PM 14 **A.** I believe so.

01:42:20PM 15 **Q.** And your timeline said, "Well, we can get it done
01:42:25PM 16 within that time period," right?

01:42:26PM 17 **A.** That was our goal. There is some notes at the bottom
01:42:32PM 18 that you can't see, but it basically talks about things
01:42:35PM 19 that have to happen for this to actually be successful.

01:42:38PM 20 **Q.** Exhibit 79, is this an updated timeline prepared
01:42:46PM 21 July 31, 2013?

01:42:48PM 22 **A.** It is.

01:42:49PM 23 **Q.** And by this time the dates had slipped somewhat,
01:42:53PM 24 right?

01:42:53PM 25 **A.** Yeah. And there is discussions about why in there.

01:42:58PM 1 Q. And even with the dates slipping and the discussion
01:43:00PM 2 about why, as of July 31, 2013, your target for wrapping
01:43:08PM 3 this up was just nine months down the road, right?

01:43:11PM 4 A. Again, we worked back from the statute of
01:43:13PM 5 limitations, which at that point in time was
01:43:15PM 6 December 31st, 2013.

01:43:19PM 7 Q. Microsoft had, I take it, agreed to still another
01:43:23PM 8 extension of the statute of limitations, right?

01:43:25PM 9 A. Yeah, they had. They were interested in hearing, at
01:43:28PM 10 least I understood at that time, where we were. And we
01:43:32PM 11 had always talked to them throughout this process about
01:43:34PM 12 trying to resolve one or more issues.

01:43:37PM 13 Q. There was -- Let me just get back here. There was a
01:43:46PM 14 possibility that you identified that there might be a need
01:43:54PM 15 for some new IDRs, some information document requests,
01:43:58PM 16 right?

01:43:59PM 17 A. Certainly there is a couple of places referred to
01:44:02PM 18 here. The top one is focusing on things we need to do to
01:44:08PM 19 get to having intelligent conversation at this resolution
01:44:11PM 20 meeting, where we present our -- Note 1 actually reserves
01:44:14PM 21 on doing interviews and IDRs outside of anything that you
01:44:17PM 22 see in the boxes above.

01:44:19PM 23 Q. Yeah. Note 1, let's look at that. I have
01:44:25PM 24 highlighted some language. Of course, the audit has been
01:44:29PM 25 going on now for six, seven years, right?

01:44:31PM 1 **A.** Yeah. At this point we are just focusing on the
01:44:35PM 2 focus with the expertise that we didn't previously have on
01:44:39PM 3 the transfer pricing issues, specifically Americas.

01:44:41PM 4 **Q.** So tons of information has already been turned over.
01:44:46PM 5 What you say there in Note 1 is, "The majority of
01:44:50PM 6 data-intensive IDRs have been issued already, and based on
01:44:53PM 7 what is currently known, we believe that all reasonably
01:44:56PM 8 anticipated IDRs will be issued by June 30" -- and that
01:45:01PM 9 would be June 30, 2013 -- "and most significantly sooner,"
01:45:08PM 10 right?

01:45:09PM 11 **A.** That was our goal. I think until we identified new
01:45:14PM 12 issues, you know, that weren't resolved after the
01:45:17PM 13 January 14th meeting, we more or less meant that -- The
01:45:21PM 14 caveat was, and I think it is reflected in the next -- in
01:45:25PM 15 either that one or this one, is -- We still had a lot of
01:45:28PM 16 questions on software code. And that was one of the
01:45:30PM 17 reasons we needed more time, to do a software code
01:45:33PM 18 analysis, and to get some answers about -- like a
01:45:36PM 19 stack-full of reports that the company had given us that
01:45:38PM 20 we didn't have previously, their internal software code
01:45:44PM 21 analysis.

01:45:44PM 22 **Q.** Exhibit 134 is a May 2013 update of timeline, right?

01:45:50PM 23 **A.** It is.

01:45:52PM 24 **Q.** And you had these software issues, other issues. Now
01:46:01PM 25 you are in the present, which would be May 30, 2013, and

01:46:08PM 1 **you are projecting that in less than a year you will be**
01:46:14PM 2 **able to resolve the issues or issue a 30-day letter,**
01:46:18PM 3 **right?**

01:46:18PM 4 **A. Yeah. So this was updated after we actually were**
01:46:22PM 5 **able to schedule our software code visits to the company.**
01:46:25PM 6 **That is in Note 2. This reflects that. And, frankly, we**
01:46:29PM 7 **were basically on this schedule until the government**
01:46:32PM 8 **shutdown. But we had a meeting scheduled with the**
01:46:34PM 9 **taxpayer, before the shutdown, for the first week in**
01:46:37PM 10 **December, which was the first availability for both the**
01:46:39PM 11 **taxpayer's executives and ours.**

01:46:41PM 12 **Q. And, once again, at the IRS's request, Microsoft had**
01:46:47PM 13 **extended the statute of limitations out to June 30, 2014,**
01:46:53PM 14 **right?**

01:46:53PM 15 **A. Yeah, they agreed to. We told them we wanted to meet**
01:46:57PM 16 **with them and discuss resolution and narrow issues, and**
01:46:59PM 17 **they agreed to extend.**

01:47:00PM 18 **Q. Also in here, what you were projecting is that within**
01:47:24PM 19 **just five months you would be able to present your**
01:47:28PM 20 **conclusions to the taxpayer, and then there would be a**
01:47:34PM 21 **period of four or five months of discussions, and by April**
01:47:41PM 22 **of 2014 you thought you would be able to wrap this up,**
01:47:43PM 23 **right?**

01:47:43PM 24 **A. We discussed this at length with Mr. Sample and**
01:47:48PM 25 **Mr. Bernard on multiple occasions. They said, "Do you**

01:47:51PM 1 really think we are going to be able to resolve all issues
01:47:54PM 2 in two or three months between the presentation and our
01:47:57PM 3 D-Day for decision?" We told them, "Look, you know, we
01:48:00PM 4 need a place to start, working back from the statute."
01:48:02PM 5 How much we resolved and how much we talked was up to
01:48:05PM 6 them. We recognized to hit all of the issues would
01:48:07PM 7 probably take more time. The ball was in their court.
01:48:12PM 8 Q. And in the event the November 2013 date for the IRS
01:48:20PM 9 presenting their conclusions ended up slipping to, I think
01:48:24PM 10 you said, January 2014, right?
01:48:26PM 11 A. After the government shutdown it was mutually
01:48:30PM 12 rescheduled for January 14th, correct. Originally we
01:48:34PM 13 scheduled for December.
01:48:35PM 14 Q. I only have an hour. I only asked you whether it
01:48:37PM 15 slipped to January 2014.
01:48:39PM 16 A. We rescheduled to January 14th, yes.
01:48:41PM 17 Q. You had a face-to-face meeting with Microsoft, right?
01:48:44PM 18 A. As well as their attorneys, yes.
01:48:46PM 19 Q. And you were the lead presenter for the IRS?
01:48:49PM 20 A. I was.
01:48:50PM 21 Q. Right?
01:48:53PM 22 A. I was.
01:48:54PM 23 Q. You had a big thick slide deck with 60, 65 or so
01:49:00PM 24 slides, right?
01:49:00PM 25 A. Two reports about 200 pages and a bunch of Excel

01:49:04PM 1 **spreadsheets.**

01:49:04PM 2 **Q. This was part of the IRS's effort to try to reach**
01:49:09PM 3 **resolution of the issues, correct?**

01:49:10PM 4 **A. It was to intelligently discuss the analysis to date,**
01:49:16PM 5 **to identify open questions we had, and to propose a path**
01:49:19PM 6 **towards resolution on those open questions.**

01:49:21PM 7 **Q. Can you say yes or no to whether this was part of the**
01:49:23PM 8 **IRS's effort to try to reach resolution of the issues?**

01:49:26PM 9 **A. It was.**

01:49:27PM 10 **Q. Thanks.**

01:49:29PM 11 **A. You're welcome.**

01:49:30PM 12 **Q. Now, in your earlier testimony you said that these**
01:49:35PM 13 **discussions irretrievably broke down in July of 2014. Do**
01:49:42PM 14 **you remember that?**

01:49:42PM 15 **A. I do. That's the first time we were unequivocally**
01:49:46PM 16 **told that they didn't want to talk to us at all, and said**
01:49:50PM 17 **finish our case.**

01:49:51PM 18 **Q. Actually, you had been told earlier than that that**
01:49:54PM 19 **Microsoft didn't want to pursue further resolution**
01:50:00PM 20 **discussions, and in fact wanted you to finally issue that**
01:50:03PM 21 **30-day letter so they could get on to tax court, right?**

01:50:07PM 22 **A. That mischaracterizes the conversations. As late as**
01:50:11PM 23 **May we were still talking to Microsoft about at least**
01:50:14PM 24 **engaging on some of the mechanical issues.**

01:50:16PM 25 **Q. On February 17th, 2014, did you and Mr. Maruca of the**

01:50:22PM 1 IRS have a conference call with Mr. Sample and Mr. Bernard
01:50:27PM 2 of Microsoft?

01:50:28PM 3 A. That sounds right.

01:50:29PM 4 Q. And did Mr. Sample inform you that Microsoft would
01:50:34PM 5 not further pursue dispute resolution discussions?

01:50:37PM 6 A. What he said at that time is -- He did say that he
01:50:42PM 7 wasn't sure they could pursue it. We expressed concerns

01:50:46PM 8 and disappointment. We also left open the door for
01:50:49PM 9 resolution. They also continued to commit to us to

01:50:51PM 10 provide us feedback on some of the open mechanical

01:50:54PM 11 questions which they had committed to on January 14th. So

01:50:58PM 12 we left that meeting still with a commitment from

01:51:02PM 13 Microsoft to engage with us on some -- not all, but some
01:51:06PM 14 of the resolution items we had hoped to discuss.

01:51:09PM 15 Q. I am putting up your sworn declaration, Exhibit 77,

01:51:13PM 16 Paragraph 41. "On February 17, 2014, on a conference call
01:51:17PM 17 held among Mr. Sample, Mr. Bernard, Mr. Maruca, and me,

01:51:22PM 18 Mr. Sample notified us that he planned to sign a statute
01:51:26PM 19 of extension that week, extending the statute to

01:51:28PM 20 December 31, 2014; that he had decided not to pursue

01:51:35PM 21 resolution discussions; and that he would like a 30-day

01:51:43PM 22 letter." Now, in your sworn declaration, when you

01:51:51PM 23 summarized what Mr. Sample said, all you said was that he
01:51:55PM 24 decided not to pursue resolution discussions and he would

01:51:58PM 25 like a 30-day letter, correct?

01:52:01PM 1 **A.** If you look a few down, it says he still remained
01:52:06PM 2 committed on giving us a 60-day feedback, I believe. And
01:52:09PM 3 on a 60-day feedback, if you have the context of the
01:52:11PM 4 January 14th meeting, and this particular conversation,
01:52:15PM 5 that feedback was on these mechanical issues that we had
01:52:18PM 6 raised questions on, how to identify revenues for
01:52:20PM 7 geographies, how to identify expenses, and how to do
01:52:23PM 8 allocations, and these math errors and judgment calls that
01:52:28PM 9 we wanted to engage on. That was what the 60-day feedback
01:52:31PM 10 was supposed to focus on.

01:52:33PM 11 **Q.** Did you issue the 30-day letter like Microsoft asked
01:52:36PM 12 you to?

01:52:36PM 13 **A.** We did not.

01:52:37PM 14 **Q.** On March 24, 2014, did you have a meeting with
01:52:42PM 15 Mr. Bernard of Microsoft, I think in Washington, DC?

01:52:49PM 16 **A.** I did.

01:52:50PM 17 **Q.** Did he reiterate Microsoft's request for a 30-day
01:52:53PM 18 letter?

01:52:53PM 19 **A.** He did.

01:52:53PM 20 **Q.** Did you issue one?

01:52:54PM 21 **A.** No.

01:52:55PM 22 **Q.** Ms. Eakes in her opening referred to Exhibit 126.
01:53:06PM 23 And we just talked about March 24, 2014, where they
01:53:12PM 24 reiterated the request for a 30-day letter. Ms. Eakes
01:53:18PM 25 referred to Exhibit 126, which was a March 28th, 2014

01:53:27PM 1 email, just a few days afterwards, where the folks at the
01:53:36PM 2 IRS are saying we really need to get this temporary
01:53:41PM 3 regulation out by June 1st, 2014.

01:53:47PM 4 Now, my question is simply, did you personally know
01:53:53PM 5 within days of being told by Mr. Bernard that further
01:54:00PM 6 discussions weren't going to work, and that Microsoft
01:54:02PM 7 wanted a 30-day letter, did you know yourself that the IRS
01:54:08PM 8 was putting the hurry-up on this temporary regulation?

01:54:12PM 9 A. I was not aware of this email or any of these
01:54:16PM 10 comments here.

01:54:17PM 11 Q. Had you told others in your group, in this timeframe,
01:54:23PM 12 that Microsoft had said further discussions aren't going
01:54:26PM 13 to work and we want the 30-day letter?

01:54:31PM 14 A. I am sure I made an internal report at some point.

01:54:34PM 15 Q. Was there anybody in your group who had that
01:54:39PM 16 information, who was dealing with the people who were
01:54:42PM 17 deciding to hurry up the temporary regulation?

01:54:45PM 18 A. Not to my knowledge.

01:54:45PM 19 Q. Who in your group would have interfaced with the guys
01:54:50PM 20 working on the temporary regulation?

01:54:54PM 21 A. I don't know about anyone in my group interfacing
01:54:57PM 22 directly with them until later -- that early June
01:55:02PM 23 timeframe. So persons in my group who I knew at some
01:55:06PM 24 point -- I don't know when they started to interact with
01:55:10PM 25 the reg, as I mentioned before, were Tom Berger -- I'm

01:55:13PM 1 **sorry, Howard Berger, Tom Ralph, and Sam Maruca.**

01:55:21PM 2 **Q. I am putting up a timeline that your counsel had**

01:55:24PM 3 **prepared for use in the case. According to your timeline**

01:55:30PM 4 **here, I will just put a little arrow next to the points I**

01:55:39PM 5 **am talking about, in November/December 2013 is when the**

01:55:51PM 6 **IRS contacted Quinn Emanuel, right?**

01:55:53PM 7 **A. Correct.**

01:55:54PM 8 **Q. Did you do the contacting?**

01:55:57PM 9 **A. Not initially, but during that timeframe and**

01:56:01PM 10 **follow-up conversations, yes.**

01:56:02PM 11 **Q. Are there records, memos, phone records, that if we**

01:56:08PM 12 **got discovery we might be able to look at that would tell**

01:56:12PM 13 **us what it was you discussed with Quinn Emanuel?**

01:56:15PM 14 **A. No. I think at that point in time there would have**

01:56:19PM 15 **been phone calls and possibly an NDA.**

01:56:23PM 16 **Q. What's an NDA?**

01:56:25PM 17 **A. A nondisclosure agreement.**

01:56:27PM 18 **Q. And you don't think there is any emails or memos that**

01:56:33PM 19 **say, "Gee whiz, Eli talked to Quinn Emanuel, and here is**

01:56:39PM 20 **where we look like we are going"?**

01:56:42PM 21 **A. Honestly, at that stage we are just reaching out to**

01:56:46PM 22 **ascertain whether there is interest in them working for**

01:56:49PM 23 **the IRS. As things progress we start to talk about the**

01:56:55PM 24 **contours of expert engagements. I honestly don't know**

01:57:00PM 25 **where in time you would start to see some documents**

01:57:06PM 1 **discussing --**

01:57:07PM 2 **Q. Somewhere in time you would start to see some**
01:57:09PM 3 **documents discussing that, which we could look at if we**
01:57:13PM 4 **got discovery, right?**

01:57:14PM 5 **A. I would imagine so, if they weren't privileged.**

01:57:17PM 6 **Q. February 25th, you actually met with Quinn Emanuel.**
01:57:22PM 7 **Where was that meeting?**

01:57:23PM 8 **A. It was in Los Angeles.**

01:57:24PM 9 **Q. Did you fly out there and attend it?**

01:57:27PM 10 **A. I did.**

01:57:28PM 11 **Q. How many people from the IRS were there?**

01:57:30PM 12 **A. Three.**

01:57:31PM 13 **Q. How many people from Quinn Emanuel were there?**

01:57:33PM 14 **A. Three or four, that I can recall.**

01:57:37PM 15 **Q. Did you generate any documents, you or your**
01:57:41PM 16 **colleagues, describing what was talked about in this**
01:57:43PM 17 **meeting with Quinn Emanuel?**

01:57:44PM 18 **A. Not describing what was talked about. I may have**
01:57:50PM 19 **used some visual aids there.**

01:57:53PM 20 **Q. And if we got discovery, we could look at your visual**
01:57:57PM 21 **aids, assuming that you don't claim some sort of**
01:57:59PM 22 **privilege, right?**

01:58:00PM 23 **A. Of course.**

01:58:00PM 24 **Q. Did you say that they didn't even know that Microsoft**
01:58:11PM 25 **was the company that they would be helping you go against?**

01:58:17PM 1 **A.** I did not say that.

01:58:18PM 2 **Q.** Okay. They did know it was Microsoft --

01:58:22PM 3 **A.** Once we have executed a nondisclosure agreement.

01:58:26PM 4 That is the first step. And after we get signed

01:58:28PM 5 nondisclosure agreements, just with respect to the people

01:58:31PM 6 that have executed them, we will inform them of the

01:58:33PM 7 potential taxpayer to eliminate things like conflicts.

01:58:38PM 8 **Q.** So when did you get these nondisclosure agreements?

01:58:43PM 9 **A.** I don't know exactly. The first one was probably in

01:58:46PM 10 that November/December timeframe.

01:58:47PM 11 **Q.** So way back in November/December they knew right from

01:58:51PM 12 the get-go that they were being asked whether they would

01:58:54PM 13 be interested in helping you go against Microsoft, right?

01:58:58PM 14 **A.** At some early point, yes.

01:59:00PM 15 **Q.** So then the engagement letter is signed on May 19th,

01:59:06PM 16 2014, right?

01:59:07PM 17 **A.** That sounds right. It was not an engagement letter,

01:59:13PM 18 we had a contract.

01:59:15PM 19 **Q.** We will come back to that. That is another subject

01:59:17PM 20 you are all geared up on for today's testimony, right?

01:59:24PM 21 **A.** If you would like to ask me about it, I would be

01:59:28PM 22 happy to answer questions.

01:59:29PM 23 **Q.** Oh, I will. Now, by May 19, 2014, the statute of

01:59:33PM 24 limitations had been extended several times, correct?

01:59:35PM 25 **A.** Yes. Each time agreed to by Microsoft.

01:59:38PM 1 Q. Right. You asked and Microsoft agreed, right?

01:59:40PM 2 A. Yes.

01:59:40PM 3 Q. And as of late 2013 -- It was set to expire in June

01:59:47PM 4 of 2014, right?

01:59:48PM 5 A. That sounds right.

01:59:50PM 6 Q. And around December of '13, did you ask Microsoft for

01:59:57PM 7 still another extension?

01:59:59PM 8 A. I don't know exactly when that request was made, but

02:00:03PM 9 sometime in December, January, February, yes.

02:00:06PM 10 Q. Sometime in December, January, February. Did you

02:00:09PM 11 tell them when you asked for this new extension that you

02:00:13PM 12 had contacted Quinn Emanuel and were in discussions with

02:00:21PM 13 Quinn Emanuel about them helping you out and going against

02:00:24PM 14 Microsoft?

02:00:25PM 15 A. We did not at that point in time inform them of our

02:00:28PM 16 discussions with Quinn Emanuel.

02:00:30PM 17 Q. And did you tell them that part of Quinn Emanuel's

02:00:35PM 18 role was -- it was contemplated that they would actually

02:00:41PM 19 appear in tax court against Microsoft? Did you tell them

02:00:45PM 20 that?

02:00:45PM 21 A. I did not tell them anything at all with respect to

02:00:49PM 22 Quinn Emanuel at that time.

02:00:51PM 23 Q. You kept all of that secret, right?

02:00:53PM 24 A. Well, I am not in the habit of discussing potential

02:00:57PM 25 experts with any taxpayer, Microsoft or otherwise, prior

02:01:00PM 1 to them having a reason to interact with the taxpayer.

02:01:02PM 2 Q. This is a little different, because you are asking

02:01:05PM 3 somebody to voluntarily extend the statute of limitations,

02:01:08PM 4 and you are concealing from them the fact that for the

02:01:10PM 5 first time ever, in your knowledge, the IRS was hiring an

02:01:14PM 6 outside law firm to help it with the audit, and looking

02:01:19PM 7 forward to representing them in tax court. You didn't

02:01:22PM 8 tell them that, did you?

02:01:23PM 9 A. In the last part, if you are asking did I tell them,

02:01:28PM 10 no, I didn't tell them. The rest of it, I don't think it

02:01:32PM 11 accurately characterizes why we asked for extensions at

02:01:33PM 12 the six-month mark. We are directed to do that at six

02:01:36PM 13 months under the IRM, the Internal Revenue Manual, it is

02:01:40PM 14 my understanding. Other people actually handle that,

02:01:42PM 15 people who manage the statutes. But at the six-month mark

02:01:46PM 16 our instructions say, no later than that, see if you can

02:01:49PM 17 get an extension. And if we don't, then we have to decide

02:01:52PM 18 what we are going to do to prepare for the statute to

02:01:54PM 19 expire.

02:01:55PM 20 Q. The meeting in February, where you had like three

02:01:58PM 21 folks from the IRS, three folks from Quinn Emanuel, did

02:02:00PM 22 you discuss with Quinn Emanuel your need to get another

02:02:06PM 23 extension of the statute of limitations if Quinn Emanuel

02:02:11PM 24 was to be able to come onboard?

02:02:13PM 25 MR. WEAVER: I will object, your Honor, and assert

02:02:17PM 1 the attorney-client privilege. Quinn Emanuel ended up
02:02:21PM 2 advising the IRS on legal matters. Although I don't
02:02:25PM 3 really care about this question, I don't want to open the
02:02:28PM 4 door to some subject matter.

02:02:29PM 5 THE COURT: The objection will be sustained.

02:02:32PM 6 By Mr. Beck:

02:02:38PM 7 Q. Was it in February of 2014, the same month that you
02:02:42PM 8 met with Quinn Emanuel, that you finally persuaded
02:02:47PM 9 Microsoft to give you still another extension of the
02:02:51PM 10 statute of limitations?

02:02:53PM 11 A. I am not sure of when they extended it.

02:02:57PM 12 Q. Exhibit 148. You can see here, I think, that this
02:03:07PM 13 extension to the end of the year was granted on
02:03:17PM 14 February 28th, 2014. Do you see that?

02:03:19PM 15 A. I do.

02:03:20PM 16 Q. So that was just a few days after your meeting with
02:03:25PM 17 Quinn Emanuel, correct?

02:03:26PM 18 A. Yes.

02:03:27PM 19 Q. Then back to our timeline -- your timeline, rather.
02:03:40PM 20 May 19, 2014, that's where your entry says you executed a
02:03:50PM 21 contract with Quinn Emanuel, right?

02:03:51PM 22 A. That's when the contracting officer awarded the
02:03:55PM 23 contract.

02:03:57PM 24 Q. Let's take a look now at Exhibit 71. This is a
02:04:11PM 25 letter from you to Mr. Bernard, dated August 28th, 2014.

02:04:20PM 1 **Do you see that?**

02:04:21PM 2 **A. I do.**

02:04:22PM 3 **Q. And you were talking about logistics for upcoming**

02:04:25PM 4 **interviews that Microsoft had agreed that they would**

02:04:30PM 5 **provide their people for, right?**

02:04:31PM 6 **A. This was our initial request for those interviews**

02:04:34PM 7 **from the pool of people that Microsoft identified.**

02:04:36PM 8 **Q. Well, you had already been in conversations with**

02:04:41PM 9 **them, and they had already agreed to make the people**

02:04:44PM 10 **available before you sent this letter, right?**

02:04:46PM 11 **A. Not necessarily. We had asked them to identify**

02:04:50PM 12 **persons who could speak to various subject matters for**

02:04:55PM 13 **purposes of scheduling these interviews. And once they**

02:04:58PM 14 **identified that pool, we made that request that these are**

02:05:02PM 15 **the people and the times we would like to speak to them.**

02:05:03PM 16 **Q. Look at your letter. Your letter says, "Thank you**

02:05:06PM 17 **for agreeing to make available for interview the below**

02:05:09PM 18 **listed employees." They had already agreed, right?**

02:05:12PM 19 **A. They had suggested them as possible persons. So,**

02:05:16PM 20 **yeah, it is basically feel-good language saying, "Hey,**

02:05:19PM 21 **thanks for talking to us, thanks for giving us candidates,**

02:05:21PM 22 **here are the people we are talking to."**

02:05:24PM 23 **Q. Actually, you said, "Thank you for agreeing to make**

02:05:28PM 24 **them available," right?**

02:05:29PM 25 **A. I did. That's what I wrote.**

02:05:29PM 1 Q. When you asked them to make these folks available,
02:05:32PM 2 did you tell them that, incidentally, we have hired
02:05:36PM 3 outside counsel for the first time in the history of the
02:05:39PM 4 universe and Quinn Emanuel is going to be asking some of
02:05:42PM 5 the questions?

02:05:43PM 6 A. This is the first letter where I informed them --

02:05:47PM 7 Q. This is the first time, am I right, that you made any
02:05:51PM 8 reference to Microsoft, after they had already agreed to
02:05:55PM 9 these interviews, that Quinn Emanuel would be involved,
02:06:00PM 10 correct?

02:06:00PM 11 A. Yes, this is the first time I told them about Quinn
02:06:05PM 12 Emanuel.

02:06:05PM 13 Q. And it was almost like an aside, Page 3, "Oh, by the
02:06:12PM 14 way, in addition to our economist and industry experts,
02:06:14PM 15 this may include outside counsel from Quinn Emanuel
02:06:16PM 16 retained to assist LB&I in its evaluation and examination
02:06:21PM 17 in this matter"? That was the entire disclosure, right?

02:06:25PM 18 A. That's what it says.

02:06:26PM 19 Q. And, of course, you really couldn't delay telling
02:06:30PM 20 them anymore because the statute of limitations was about
02:06:33PM 21 to expire, right?

02:06:34PM 22 A. Listen, we didn't have Quinn Emanuel hired and on
02:06:39PM 23 board and cleared to do work until the middle of July. We
02:06:42PM 24 had started discussions with them, with Microsoft, prior
02:06:45PM 25 to that. As early as May we actually asked them to

02:06:48PM 1 identify people. This was the first time where we
02:06:51PM 2 actually started to receive the names from Microsoft. And
02:06:54PM 3 we could say, yeah, we would like to talk to some of the
02:06:57PM 4 people you have identified.

02:06:58PM 5 Q. Was the statute --

02:06:59PM 6 A. This was an appropriate time in my mind --

02:07:00PM 7 Q. Was the statute about to expire? My question was,
02:07:03PM 8 was the statute of limitations about to expire?

02:07:06PM 9 A. The statute of limitations was set to expire December
02:07:09PM 10 31st, 2014.

02:07:11PM 11 Q. And were you concerned that if you showed up with
02:07:13PM 12 Quinn Emanuel completely unannounced before these
02:07:16PM 13 interviews took place, the interviews wouldn't go forward,
02:07:20PM 14 right?

02:07:20PM 15 A. I told them about a month before we asked for them so
02:07:25PM 16 they had an opportunity to consider them. Certainly I
02:07:27PM 17 wanted them to know. And if they had some issues, which
02:07:30PM 18 they did, they were free to raise them, which they did.

02:07:32PM 19 Q. Let's take a look at how they raised the issues and
02:07:35PM 20 how you responded. Exhibit 72, this is Mr. Bernard's
02:07:49PM 21 response to you?

02:07:49PM 22 A. It is.

02:07:50PM 23 Q. He says we are going to go forward with the
02:07:56PM 24 interviews on a consensual basis, right?

02:08:03PM 25 A. I suppose so, yes.

02:08:08PM 1 Q. Then over on Page 2 he has a discussion of concerns
02:08:13PM 2 about Quinn Emanuel, correct?
02:08:15PM 3 A. He does.
02:08:18PM 4 Q. And, again, with time being what it is, I will try to
02:08:22PM 5 summarize. The one thing he asked you was, are you
02:08:29PM 6 claiming these guys are going to be expert witnesses, or
02:08:36PM 7 are they going to be representing IRS as trial counsel if
02:08:40PM 8 this proceeds to go to litigation, right?
02:08:44PM 9 A. That is the sentence.
02:08:46PM 10 Q. And then he says, "We are concerned about their
02:08:49PM 11 involvement. They have been adverse to us in many
02:08:54PM 12 matters. They represent our biggest competitors." Did
02:08:57PM 13 you take any of that into account when you decided that
02:09:00PM 14 Quinn Emanuel is the right firm to go against Microsoft?
02:09:03PM 15 A. You mean that they have been --
02:09:07PM 16 Q. That they had 30 open matters adverse to Microsoft,
02:09:12PM 17 did you take that into account?
02:09:13PM 18 A. I took into account whether they had the expertise
02:09:15PM 19 needed, and whether or not there was a conflict that would
02:09:18PM 20 bar them from representing the IRS or bar them from being
02:09:21PM 21 adverse to Microsoft.
02:09:23PM 22 Q. Did you take into account they had 30 open matters
02:09:26PM 23 against Microsoft when you decided they are the right
02:09:29PM 24 people to go against Microsoft on their behalf?
02:09:33PM 25 MR. WEAVER: Objection. Foundation.

02:09:34PM 1 **THE COURT:** The objection will be sustained.

02:09:35PM 2 **By Mr. Beck:**

02:09:35PM 3 **Q.** Did you make any inquiry as to how many open active

02:09:38PM 4 matters they had against Microsoft?

02:09:42PM 5 **A.** I did not ask them the number of matters of which

02:09:45PM 6 they were adverse to Microsoft.

02:09:47PM 7 **Q.** Did you later learn that it was 30 or more? Yes or

02:09:52PM 8 no, did you later learn that it was 30 or more?

02:09:54PM 9 **A.** There is a list on the document that was provided to

02:09:57PM 10 Microsoft. I don't know if those were current matters or

02:10:00PM 11 historical ones. I don't know how many at any point in

02:10:02PM 12 time they were adverse.

02:10:03PM 13 **Q.** You didn't care, right?

02:10:05PM 14 **A.** I didn't see it as an issue. Their being adverse to

02:10:08PM 15 Microsoft in our case has no bearing, in my mind, whether

02:10:11PM 16 they are adverse in another, particularly when those

02:10:14PM 17 attorneys are not working on those other cases that are

02:10:16PM 18 active.

02:10:16PM 19 **Q.** Did you ask whether some of the biggest clients of

02:10:22PM 20 Quinn Emanuel also happened to be the biggest competitors

02:10:24PM 21 of Microsoft?

02:10:26PM 22 **A.** I had no reason to.

02:10:27PM 23 **Q.** It was of no interest to you that the people that you

02:10:32PM 24 were going to be turning all of our confidential

02:10:34PM 25 information over to were like principal outside counsel

02:10:39PM 1 for our biggest competitors, Google, Motorola?

02:10:43PM 2 MR. WEAVER: Objection. Foundation.

3 By Mr. Beck:

02:10:48PM 4 Q. Well, you later learned from us --

02:10:48PM 5 THE COURT: Just a second.

02:10:52PM 6 By Mr. Beck:

7 Q. You later learned from us, did you not --

02:10:53PM 8 I am withdrawing it and asking a different question.

9 THE COURT: Thank you.

10 By Mr. Beck:

02:10:55PM 11 Q. You later learned when we were complaining that one

02:10:57PM 12 of the reasons we didn't like this was because Quinn

02:11:01PM 13 Emanuel is outside counsel for Google and Motorola, two of

02:11:05PM 14 our biggest competitors, right?

02:11:08PM 15 A. I don't recall the actual names of the competitors

02:11:11PM 16 that were listed. I do recall Microsoft raising concerns

02:11:15PM 17 that Quinn Emanuel -- other attorneys, not necessarily the

02:11:18PM 18 ones that we hired, but other attorneys at Quinn Emanuel

02:11:20PM 19 were adverse to them.

02:11:21PM 20 Q. Did you make any inquiry into whether Quinn Emanuel

02:11:25PM 21 had a rather unfortunate recent history in being

02:11:29PM 22 sanctioned for not maintaining the confidentiality of

02:11:33PM 23 documents that had been entrusted in their care?

02:11:36PM 24 MR. WEAVER: Objection. Foundation.

02:11:37PM 25 THE COURT: The objection is sustained.

02:11:39PM 1 **By Mr. Beck:**

02:11:40PM 2 **Q. Did you make inquiry?**

02:11:41PM 3 **MR. WEAVER: The same objection.**

02:11:43PM 4 **THE COURT: Sustained.**

02:11:43PM 5 **By Mr. Beck:**

02:11:43PM 6 **Q. Did you make any inquiry at all as to whether Quinn**
02:11:49PM 7 **Emanuel had been sanctioned in recent years concerning**
02:11:52PM 8 **their handling of confidential information?**

02:12:00PM 9 **A. No, not as part of the market survey. We did a**
02:12:03PM 10 **background check, we asked questions about the substance,**
02:12:06PM 11 **we talked to people we wanted to hire. That was the kind**
02:12:10PM 12 **of things we focused on, did they have the expertise, did**
02:12:13PM 13 **they seem like they were professional, did they understand**
02:12:15PM 14 **the obligations they would have to protect information if**
02:12:18PM 15 **you're hired as IRS contractors. That was the focus of**
02:12:20PM 16 **our inquiry at that stage.**

02:12:22PM 17 **Q. Did you know from news reports about their troubles**
02:12:24PM 18 **in that regard?**

02:12:25PM 19 **A. No.**

02:12:25PM 20 **Q. Let's look at Exhibit 73, your response to**
02:12:33PM 21 **Mr. Bernard. Over on Page 3, I want to focus on a couple**
02:12:50PM 22 **of the comments. This second paragraph you say, "Quinn**
02:13:00PM 23 **Emanuel has been hired to assist LB&I in its ongoing**
02:13:04PM 24 **evaluation and examination." That means the audit, right?**

02:13:08PM 25 **A. It does.**

02:13:09PM 1 Q. "As communicated in prior discussions, the IRS has
02:13:12PM 2 not yet made a determination on how to process the agreed
02:13:16PM 3 issues in the fiscal 04/06 cycle, all options remain open,
02:13:24PM 4 and you can anticipate a final decision after the
02:13:26PM 5 interviews scheduled for September and October." Did that
02:13:30PM 6 mean at long last we were going to get either an all-clear
02:13:33PM 7 or a 30-day letter once these interviews took place?

02:13:37PM 8 A. No. As we discussed with Mr. Sample, and
02:13:41PM 9 Mr. Bernard, and as is referred to in Mr. Bernard's
02:13:44PM 10 outline for the March meeting, the options in play at that
02:13:47PM 11 point in time that we discussed with them were a 30-day
02:13:52PM 12 letter, it was a statutory notice of deficiency, or a
02:13:55PM 13 statutory notice of deficiency combined with a designation
02:13:57PM 14 for litigation.

02:13:59PM 15 Q. Wrap it up one way or another after the meetings in
02:14:04PM 16 September and October, right?

02:14:05PM 17 A. The same options that are available in every
02:14:07PM 18 examination, yes.

02:14:08PM 19 Q. And that's what they could anticipate, you told them,
02:14:11PM 20 in this letter, correct?

02:14:12PM 21 A. Yeah. We thought that the September and October
02:14:16PM 22 interviews would finish our factual development at that
02:14:19PM 23 point in time based on what we knew then.

02:14:21PM 24 Q. And you said that -- you assured them that Quinn
02:14:24PM 25 Emanuel had not been retained for litigation support,

02:14:26PM 1 right?

02:14:26PM 2 A. Well, the contract that was awarded was limited to
02:14:30PM 3 examination support.

02:14:32PM 4 Q. Well, you didn't say in the specific contract that
02:14:35PM 5 has been awarded it is limited to audit support, you said
02:14:41PM 6 Quinn Emanuel has not been retained for litigation
02:14:43PM 7 support, right?

02:14:43PM 8 A. Well, if you remember the last letter that you showed
02:14:46PM 9 me, it only gave two options. It was -- I don't remember
02:14:49PM 10 the first one, but it was basically expert witnesses or it
02:14:52PM 11 was trial litigation counsel. Well, they were retained to
02:14:56PM 12 provide support, consultation, legal advice, and support
02:14:58PM 13 during the examination. That was the contract that was
02:15:00PM 14 awarded. As we discussed previously today, we certainly
02:15:04PM 15 knew there was a possibility that if -- that things might
02:15:08PM 16 go to litigation, that they could, and if the IRS chose,
02:15:10PM 17 we could hire them in a new contract, but not this one,
02:15:14PM 18 because it didn't cover it.

02:15:15PM 19 Q. Well, you didn't tell them that in this letter. In
02:15:18PM 20 fact, you told them there was no contract?

02:15:20PM 21 A. I didn't say there was no contract.

02:15:22PM 22 Q. The next page. "The IRS does not have an engagement
02:15:27PM 23 letter with Quinn Emanuel." That's what you told them,
02:15:30PM 24 right?

02:15:30PM 25 A. I said no engagement letter. I did refer to the

02:15:33PM 1 scope of work.

02:15:34PM 2 Q. Yeah. But an engagement letter, of course you know
02:15:39PM 3 what that is, when you hire a lawyer it is a contract
02:15:42PM 4 between the client and the lawyer for the provision of
02:15:46PM 5 legal services, right?

02:15:48PM 6 A. Yeah, it is typically a letter on firm letterhead.

02:15:52PM 7 We don't have that in this case. We have a contract.

02:15:54PM 8 Now, in hindsight would it have been better to provide a
02:15:57PM 9 contract or make it a little more clear? Yes. But

02:16:00PM 10 Microsoft is a sophisticated taxpayer. And I discussed

02:16:03PM 11 the contracting process. And I know from past

02:16:04PM 12 conversations with them that they know that we award

02:16:06PM 13 contracts, not engagement letters. I wasn't ready at this
02:16:09PM 14 point in time to share a document that I was still

02:16:12PM 15 considering whether or not we could share it with them.

02:16:14PM 16 And this bought me some time.

02:16:16PM 17 Q. You tricked them?

02:16:17PM 18 A. I don't think I tricked them. I described the scope
02:16:19PM 19 of work.

02:16:19PM 20 Q. Let's back up. They said, "Give us a copy of the
02:16:22PM 21 engagement letter." And you said, "I don't have an

02:16:25PM 22 engagement letter." And your explanation is, "They are
02:16:29PM 23 sophisticated. If they ask for an engagement letter, it

02:16:33PM 24 is fair for me to conceal the fact that I have a contract
02:16:36PM 25 because they didn't use the word 'contract'?"

02:16:38PM 1 **A.** The contract was public record. It was published on
02:16:41PM 2 the website. Mr. Bernard has previously looked at the
02:16:45PM 3 website for other contracts and seen when we --

02:16:47PM 4 **Q.** Answer my question, will you?

02:16:48PM 5 **A.** He asked for an engagement letter; we don't have one.

02:16:51PM 6 **Q.** And you didn't tell him you had a contract, did you?

02:16:53PM 7 **A.** I told him we had a scope of work.

02:16:58PM 8 **Q.** Who else was in on the decision to conceal the fact
02:17:02PM 9 that you had a contract?

02:17:04PM 10 **MR. WEAVER:** Objection. Mischaracterizes the
02:17:06PM 11 testimony.

02:17:06PM 12 **THE COURT:** The objection will be sustained.

02:17:08PM 13 **By Mr. Beck:**

02:17:08PM 14 **Q.** Who else did you talk to in the IRS about how when
02:17:12PM 15 responding to the request for the engagement letter, we
02:17:15PM 16 are going to say there is no engagement letter, and we are
02:17:18PM 17 not going to tell them that we have a contract?

02:17:21PM 18 **A.** I never discussed with anyone at the IRS not telling
02:17:24PM 19 them we had a contract. I did discuss with other persons
02:17:28PM 20 whether or not we had -- how we should respond here. To
02:17:31PM 21 the extent I had those discussions, it would have been
02:17:33PM 22 with IRS counsel.

02:17:35PM 23 **Q.** So this letter of yours followed discussions where
02:17:40PM 24 you got legal advice from counsel. Can you tell us which
02:17:44PM 25 lawyers? Was it Quinn Emanuel?

02:17:47PM 1 **A. I discussed the issues with Bob Ratchford, IRS**

02:17:51PM 2 **counsel.**

02:17:52PM 3 **Q. How about anybody from Quinn Emanuel?**

02:17:54PM 4 **A. I made Quinn Emanuel aware that we had notified**

02:18:00PM 5 **Microsoft in this letter as to their being hired to assist**

02:18:06PM 6 **us in the examination.**

02:18:09PM 7 **Q. So then Mr. Bernard responds. And what he tells**

02:18:21PM 8 **you -- what you understood from this paragraph was that**

02:18:26PM 9 **even though you told them there was no engagement letter,**

02:18:29PM 10 **he had gone to a website where all government agencies are**

02:18:34PM 11 **required to post the existence of contracts. And he**

02:18:39PM 12 **discovered, notwithstanding what you told them, that in**

02:18:42PM 13 **fact there was a contract. He actually had the little**

02:18:48PM 14 **contract number. So he wrote back to you and said,**

02:18:54PM 15 **"Whether you want to call it an engagement letter, a**

02:18:57PM 16 **contract, an undertaking, give us the document," right?**

02:19:01PM 17 **A. He said what he said.**

02:19:03PM 18 **Q. So we reiterated, Microsoft did, the request for the**

02:19:13PM 19 **unredacted copy of the contract, right?**

02:19:17PM 20 **A. Yeah. This was the first time they specifically**

02:19:22PM 21 **asked for a contract, yes.**

02:19:23PM 22 **Q. But even you admit that here he used the language**

02:19:31PM 23 **where -- he said, "I want the contract." You had a**

02:19:34PM 24 **contract. And he asked for an unredacted one, right?**

02:19:37PM 25 **A. Yeah, that is what he asked for.**

02:19:38PM 1 Q. You didn't give him one, though, did you?

02:19:40PM 2 A. I gave him an unredacted copy of the scope of work,

02:19:44PM 3 which describes all of the substantive work that Quinn

02:19:46PM 4 Emanuel was hired to perform.

02:19:47PM 5 Q. He asked for the unredacted copy of the contract, and

02:19:50PM 6 you didn't give him an unredacted copy of the contract,

02:19:53PM 7 did you?

02:19:53PM 8 A. I gave him what I was personally comfortable giving

02:19:56PM 9 him.

02:19:59PM 10 Q. Is there some reason that you wanted to conceal the

02:20:02PM 11 rest of the contract?

02:20:03PM 12 A. The reason I gave him the Schedule C was because

02:20:10PM 13 that's what describes the complete scope of work, what we

02:20:13PM 14 had asked them -- or hired them to perform. The reason I

02:20:14PM 15 didn't give him the rest is that I am not in the habit of

02:20:18PM 16 turning over IRS documents, particularly ones I am not the

02:20:21PM 17 custodian for, in total. And it is not under my expertise

02:20:25PM 18 what is or is not redacted.

02:20:28PM 19 So normally, my understanding is, when you want -- if

02:20:34PM 20 a taxpayer wants documents, unless someone decides on

02:20:37PM 21 their own to give out some portion of it, and we can

02:20:40PM 22 always make that choice, they go through our disclosures

02:20:43PM 23 office. They are the ones who know what gets redacted and

02:20:46PM 24 what doesn't. That is outside of my knowledge. And I was

02:20:49PM 25 comfortable giving him Schedule C, because that is the

02:20:53PM 1 meat of it, that is what we asked them to do. I thought
02:20:55PM 2 that would show them the four corners of what they had
02:20:57PM 3 been hired to do under this contract.

02:20:59PM 4 Q. Did you consult with counsel again on how you were
02:21:04PM 5 going to respond before you wrote this letter?

02:21:07PM 6 A. I made the decision on what to release myself. To
02:21:13PM 7 the extent there was ongoing discussions that required
02:21:18PM 8 legal advice, yes, I would have consulted with counsel.

02:21:22PM 9 Q. And here you not only said Section C contains the
02:21:25PM 10 full and unredacted performance, work statement, scope of
02:21:31PM 11 work, you said that was for all phases of the contract,
02:21:35PM 12 and the contract has one phase only. That's what you
02:21:39PM 13 represented to them, didn't you?

02:21:40PM 14 A. Yeah. And that's the truth.

02:21:42PM 15 Q. Let's take a look at that. In any event, before we
02:21:50PM 16 take a look at the actual contract to see whether that is
02:21:52PM 17 the truth, based on these representations that you made,
02:21:57PM 18 Microsoft agreed to go forward with those interviews,
02:22:01PM 19 right?

02:22:02PM 20 A. So the first week we didn't have Quinn Emanuel
02:22:06PM 21 present, but the interviews went forward. The second and
02:22:09PM 22 third weeks there were ongoing discussions about
02:22:14PM 23 procedures. And I don't think they were resolved at this
02:22:17PM 24 point in time. I don't think they were resolved until
02:22:20PM 25 maybe the 18th.

02:22:25PM 1 THE COURT: You have ten minutes, Mr. Beck.

02:22:27PM 2 MR. BECK: Thank you, your Honor.

02:22:29PM 3 By Mr. Beck:

02:22:32PM 4 Q. After the interviews -- you made this representation

02:22:39PM 5 to us, did you later learn that we had filed a FOIA

02:22:44PM 6 request on September 24, 2014, asking for a full

02:22:51PM 7 unredacted copy of the contract?

02:22:53PM 8 A. I did.

02:22:54PM 9 Q. Did you have anything to do with whether that FOIA

02:23:01PM 10 request should be responded to?

02:23:03PM 11 A. No.

02:23:03PM 12 Q. We eventually got a full unredacted copy of the

02:23:08PM 13 contract. Did you learn that?

02:23:10PM 14 A. I know you got a copy. I think there might be some

02:23:13PM 15 things that were redacted. I honestly don't know.

02:23:16PM 16 Q. Exhibit 64, that's a copy of the contract, right?

02:23:22PM 17 A. It looks like the first page.

02:23:25PM 18 Q. Did you negotiate this contract with Quinn Emanuel?

02:23:28PM 19 A. I don't negotiate contracts. That is a function that

02:23:31PM 20 the procurement officer does.

02:23:34PM 21 Q. What was your role in terms of the terms of this

02:23:38PM 22 contract?

02:23:39PM 23 A. I provided some input on the Schedule C that you saw;

02:23:43PM 24 and I also would have provided comments on F-6, which is

02:23:47PM 25 the delivery schedule; and I also would have provided some

02:23:53PM 1 comments because of the unique character of this with
02:23:55PM 2 respect to -- I think it is H-20. It is basically where
02:24:00PM 3 we talk about these extra hurdles we have to go through
02:24:03PM 4 because Quinn Emanuel, they were attorneys, they are a law
02:24:07PM 5 firm, and they had to comply with conflicts rules under
02:24:10PM 6 the relevant ethics rules.

02:24:13PM 7 Q. Let's take a look first over on Page 4. You gave us
02:24:21PM 8 Schedule C; is that right -- or Section C?

02:24:23PM 9 A. Yeah. So it is Section C. I guess I have been
02:24:27PM 10 talking "schedule." Originally in my letter I attached
02:24:31PM 11 Section C, yes.

02:24:31PM 12 Q. That is the only thing you gave us, right, Section C?

02:24:34PM 13 A. That was the only thing I was personally responsible
02:24:37PM 14 for providing Microsoft, yes.

02:24:38PM 15 Q. That is the only thing you gave us, right?

02:24:40PM 16 A. Well, there is descriptions of what they did or
02:24:42PM 17 didn't do, and what their conflicts were, in the letter,
02:24:45PM 18 so it is not the only thing I gave you.

02:24:46PM 19 Q. So now Section B, something that you didn't give us,
02:24:51PM 20 section B says, "Performance outside of the scope and/or
02:24:55PM 21 above the firm fixed price." And then it says, "For each
02:25:01PM 22 phase." Do you see that?"

02:25:02PM 23 A. I do. If you look at the schedules there is only one
02:25:04PM 24 phase.

02:25:05PM 25 Q. You told us there was only one phase, but the

02:25:07PM 1 contract talks about each phase, right?

02:25:09PM 2 A. Yeah. So this is pro forma language. Oftentimes you

02:25:14PM 3 will see references to each phase or look at the phases.

02:25:17PM 4 But then you have to look at the schedule, which I think

02:25:19PM 5 is either the page before or page after this, and then

02:25:23PM 6 Schedule C -- or Section C to see what the phases are. If

02:25:26PM 7 there is only one phase, then this only applies to one

02:25:29PM 8 phase.

02:25:29PM 9 Q. And there is a fixed price of \$2,185,500, right?

02:25:36PM 10 A. That sounds right, yep.

02:25:38PM 11 Q. That was for all phases, though, right?

02:25:40PM 12 A. For the one and only phase that they had awarded the

02:25:45PM 13 contract for, yes.

02:25:45PM 14 Q. You said before, you anticipated that that work would

02:25:49PM 15 all get wrapped up before the end of 2014, and you were

02:25:55PM 16 paying Quinn Emanuel over \$2 million for the work they

02:26:03PM 17 did, giving you a gut check on the audit between July,

02:26:06PM 18 when you claim they started work, and the end of 2014,

02:26:11PM 19 when you said the audit would be over?

02:26:14PM 20 A. I think that mischaracterizes some things. Would you

02:26:19PM 21 like me to explain why?

02:26:21PM 22 Q. No. And then it says, "Funding for each of the

02:26:29PM 23 phases is dependent on the litigation schedule of the

02:26:31PM 24 government, the court's scheduling, if required, appeals,

02:26:47PM 25 settlements, and/or final disposition of the taxpayer

02:26:52PM 1 **case." Is it your sworn testimony that this is all just**
02:26:55PM 2 **boilerplate, and there was nothing contemplated other than**
02:27:00PM 3 **that work in Phase I?**

02:27:03PM 4 **A. Let me be very clear. There was only one phase**
02:27:06PM 5 **awarded. You have that. It is limited to examination**
02:27:09PM 6 **support. There is a schedule before this that specifies**
02:27:12PM 7 **hours that -- under this not-to-exceed limit on this page.**
02:27:16PM 8 **That is only one phase.**

02:27:17PM 9 **My understanding -- and I am not responsible for the**
02:27:20PM 10 **final contracting, but my understanding is that**
02:27:22PM 11 **contracting officers work off of templates. And they are**
02:27:25PM 12 **doing a lot of cutting and pasting. And I know for a fact**
02:27:30PM 13 **that this contracting officer works with experts at the**
02:27:33PM 14 **trial stage, and also at the examination stage.**

02:27:35PM 15 **And, frankly, particularly when comparing this to the**
02:27:40PM 16 **Boies Schiller contract, this has a lot of sloppy language**
02:27:43PM 17 **in there that looks like it is artifacts or copy-and-paste**
02:27:46PM 18 **errors that should not apply here. Quinn Emanuel was not**
02:27:49PM 19 **hired to be an expert witness, and that phrase doesn't**
02:27:53PM 20 **appear in the Boies contract.**

02:27:54PM 21 **Q. I have to ask you to stop. I don't have that much**
02:27:57PM 22 **time, and you are not responding.**

02:27:58PM 23 **Over on "period of performance," you say that**
02:28:01PM 24 **Phase I was going to end at the end of 2014, but the**
02:28:05PM 25 **contract extended through the end of 2016. Do you see**

02:28:10PM 1 **that?**

02:28:10PM 2 **A.** I didn't say Phase I was the end. If you went to F-6
02:28:14PM 3 you will see what I saw as -- First of all, this, while
02:28:17PM 4 we are looking at this, this clearly has typos in it.
02:28:21PM 5 Someone has this period of performance right in the middle
02:28:23PM 6 of this other paragraph, and the sentences don't make
02:28:25PM 7 sense. So there is clearly something going on in there
02:28:28PM 8 that has got some editing artifacts. If you go to F-6,
02:28:32PM 9 which on the next page, it actually says the period of
02:28:34PM 10 performance is through December 31st of 2015. And it
02:28:37PM 11 describes one phase. And right below this, F-5, it
02:28:40PM 12 actually says 18 months. And if you add 18 months to when
02:28:44PM 13 the contract was awarded, that actually gets you, roughly
02:28:48PM 14 speaking, to December of 2015, not 2016. So this
02:28:52PM 15 obviously could have been drafted better. If you look at
02:28:55PM 16 F-6, that's what I understood the schedule to be, which is
02:28:58PM 17 on the next page of this contract.

02:29:00PM 18 **Q.** Time is running short, so I will try to cut to the
02:29:03PM 19 chase here. The truth is that -- with Quinn Emanuel, the
02:29:11PM 20 deal was that if and when this got to the tax court, Quinn
02:29:21PM 21 Emanuel was committed to being trial counsel in the tax
02:29:25PM 22 court, but the IRS retained the authority to say we don't
02:29:30PM 23 want you after all; isn't that true?

02:29:33PM 24 **A.** There is no obligation under this contract for that
02:29:36PM 25 to happen, but the IRS -- as we mentioned, we sort of

02:29:40PM 1 contemplated that we might get to tax court; and if we
02:29:43PM 2 did, we might want Quinn Emanuel to assist. If that did
02:29:46PM 3 happen, it would have to be subject to a new contract.
02:29:48PM 4 Those were certainly consistent with the discussions we
02:29:51PM 5 had early on.

02:29:51PM 6 Q. You are awfully familiar with every page of this
02:29:55PM 7 contract. Don't you know that this contract says that
02:30:00PM 8 Quinn Emanuel commits that they will act in the capacity
02:30:04PM 9 of special government employee, which is something they
02:30:08PM 10 would have to do to be in the tax court, that they will
02:30:11PM 11 resolve all conflicts in order to be able to get into the
02:30:15PM 12 tax court, and that the contract is non-severable on these
02:30:23PM 13 different stages, and that Quinn Emanuel must agree to act
02:30:29PM 14 in the tax court, but you have the right to say you don't
02:30:31PM 15 want them?

02:30:32PM 16 A. That is actually not what the contract says. It says
02:30:35PM 17 they have to preserve their ability to be special
02:30:37PM 18 government employees. It doesn't require them to. You
02:30:39PM 19 can't force someone to be an employee under a contract.
02:30:42PM 20 That would be a future decision for the IRS. And they
02:30:46PM 21 weren't preserving the ability to do -- just like we want
02:30:48PM 22 any expert we hire, to make sure that they are available
02:30:51PM 23 wherever a case goes, regardless of whether the audit goes
02:30:54PM 24 to trial or to appeals.

02:30:55PM 25 Q. You do now agree that the contract contemplates not

02:31:01PM 1 just what you call Phase I, but it contemplates at least
02:31:07PM 2 another phase where Quinn Emanuel would be involved in the
02:31:10PM 3 tax court, right?

02:31:12PM 4 MR. WEAVER: Objection. Mischaracterizes
02:31:14PM 5 testimony and the document.

02:31:16PM 6 THE COURT: Overruled. Do you agree or not?

02:31:17PM 7 THE WITNESS: I disagree with that statement.

02:31:20PM 8 By Mr. Beck:

02:31:20PM 9 Q. And you claim that the contract doesn't address
02:31:23PM 10 whether Quinn Emanuel is going to participate in the tax
02:31:27PM 11 court?

02:31:28PM 12 A. It does not say whether they will or won't. It asks
02:31:32PM 13 them to preserve their ability to become special
02:31:34PM 14 government employees and to preserve -- to avoid conflicts
02:31:40PM 15 that may prevent that. There is only one phase of this
02:31:43PM 16 contract. We do not go outside of contracts and perform
02:31:46PM 17 work outside of them. That would be illegal. We would
02:31:48PM 18 have to have a new contract for post-examination support
02:31:51PM 19 if we were paying them hourly. And if we did hire them at
02:31:54PM 20 some point -- Could the IRS say, "We want to hire you as
02:31:57PM 21 special government employees"? Certainly.

02:32:00PM 22 Q. Are there written side deals here that you haven't
02:32:03PM 23 told us about with Quinn Emanuel?

02:32:05PM 24 A. There are no other contracts other than the one you
02:32:07PM 25 have with Quinn Emanuel.

02:32:08PM 1 Q. Now, that makes me a little nervous. I asked for
02:32:11PM 2 "side deals," and you said "contracts." If we asked for
02:32:16PM 3 an engagement letter, you say that is not the same thing
02:32:19PM 4 as a contract. Are there any side deals?

02:32:23PM 5 A. There is no written deals, no. There is nothing
02:32:24PM 6 binding on the IRS, there is nothing binding on Quinn
02:32:27PM 7 Emanuel. I am not sure what your characterization of
02:32:30PM 8 "side deal" is. If you want to give me a definition, I
02:32:33PM 9 will answer your question better.

02:32:34PM 10 Q. You say there is nothing in writing. You had
02:32:36PM 11 discussions with Quinn Emanuel, and you said, "Here is the
02:32:39PM 12 deal, John: We will give you \$2 million as a contractor,
02:32:47PM 13 and you will participate in what we are calling Phase I.
02:32:52PM 14 And then later on, when it comes time for the tax court,
02:32:57PM 15 you are going to have to take a big haircut, because when
02:33:00PM 16 you act as an SGE, you don't get paid very much. But the
02:33:06PM 17 deal is we will front end load it, give you \$2 million for
02:33:09PM 18 Phase I. Later on we will enter into the agreement for
02:33:13PM 19 the tax court, and you are going to have to take a
02:33:17PM 20 haircut." You had those conversations with John Quinn,
02:33:19PM 21 didn't you?

02:33:19PM 22 A. What you just described does not accurately reflect
02:33:22PM 23 any conversations I had with John Quinn.

02:33:23PM 24 Q. Why don't you tell us about the conversations you had
02:33:27PM 25 with John Quinn where you talked about how you were going

02:33:31PM 1 to manage the fact that they later on would be in the tax
02:33:35PM 2 court?

02:33:36PM 3 A. It wasn't "would be," it was a possibility.

02:33:38PM 4 Q. Tell us what you said, what Quinn said.

02:33:41PM 5 A. I can't tell you specifically. But if you are asking
02:33:45PM 6 me about what was the concept, the concept as we

02:33:49PM 7 approached them was, "We would like to get your assistance
02:33:52PM 8 at this examination stage." As reflected in the contract,

02:33:55PM 9 there was two types of assistance we thought we wanted.

02:33:59PM 10 It was, "Give us a gut check, a sounding board on our
02:34:01PM 11 analysis and the taxpayer's, and to the extent new things

02:34:06PM 12 are identified, continue the case on development and

02:34:09PM 13 support." We told them that we hoped to engage the

02:34:12PM 14 taxpayer on resolution. We didn't know if that would be

02:34:14PM 15 successful. Remember, we are talking to them before

02:34:16PM 16 Microsoft says get lost.

02:34:18PM 17 Q. And remember, I asked you about a conversation you

02:34:22PM 18 had concerning how you are going to handle how they get

02:34:25PM 19 hired to come into the tax court?

02:34:27PM 20 A. I am trying to give you the conversation that you

02:34:29PM 21 have asked me about. Then it was, "Well, what happens if
02:34:33PM 22 you don't? What if Microsoft doesn't want to resolve,

02:34:35PM 23 what would you do?" We said, "Well, at that point in time
02:34:38PM 24 the IRS would have to make some decisions. We have

02:34:40PM 25 different options. We could do a 30-day letter, we could

02:34:43PM 1 do a 90-day letter, we could do a 90-day letter and
02:34:46PM 2 designation."

02:34:47PM 3 Potentially -- Certainly -- Could this wind up in
02:34:50PM 4 tax court? Yeah, just like any examination. And at that
02:34:52PM 5 point in time the IRS would have to say, "We want you to
02:34:55PM 6 be available. If we are both happy with each other on the
02:34:58PM 7 front end, maybe we will award another contract for a
02:35:01PM 8 trial phase."

02:35:02PM 9 And initially the concept was that there would be
02:35:04PM 10 another contract ordered with hourly rates. And it was
02:35:08PM 11 contemplated at some point in time there may be a need for
02:35:11PM 12 them to become special government employees. But there
02:35:14PM 13 was potentially, as conceived, examination support under
02:35:17PM 14 the contract that was awarded. That was all that was
02:35:20PM 15 awarded. A potential for a new contract if this ever left
02:35:25PM 16 examination's jurisdiction and went to Counsel's
02:35:28PM 17 jurisdiction. Counsel has jurisdiction over tax court
02:35:32PM 18 cases, not the examination side of the IRS.

02:35:34PM 19 And then at some even further future point, if a bunch
02:35:37PM 20 of things fell into place, and the IRS wanted to pursue
02:35:40PM 21 it, there was a possibility the IRS may say, "Hey, you
02:35:43PM 22 will need to become an SGE." That was what was discussed.

02:35:46PM 23 Q. And if they came in as SGEs, special government
02:35:49PM 24 employees, they wouldn't be able to charge a thousand
02:35:52PM 25 dollars an hour, or even what their paralegals charge,

02:35:56PM 1 \$300 an hour, right?

02:35:58PM 2 A. My understanding is that there is caps. I don't
02:36:01PM 3 think it is an hourly wage, though. I don't know
02:36:04PM 4 exactly --

02:36:05PM 5 Q. It is way, way lower. You know that, don't you, sir?

02:36:08PM 6 A. I know they are lower. I am just pointing out I
02:36:11PM 7 don't know how it is calculated.

02:36:14PM 8 MR. BECK: I guess my time is up, your Honor.

02:36:18PM 9 Just for the record, given the length of his answers and
02:36:20PM 10 things, I feel like I was constrained here and didn't get
02:36:26PM 11 to some of the subjects that I would have like to have
02:36:29PM 12 gotten to. On the other hand, I appreciate your patience.

02:36:33PM 13 THE COURT: Thank you, Mr. Beck.

02:36:35PM 14 Mr. Weaver, we will go ahead and take our break for
02:36:38PM 15 our court reporter. When we come back, you can begin your
02:36:42PM 16 examination at that point.

02:50:11PM 17 (Break.)

02:50:11PM 18 THE COURT: Mr. Weaver, you may inquire.

02:50:22PM 19 MR. WEAVER: May I proceed, your Honor?

02:50:23PM 20 THE COURT: You may begin.

02:50:25PM 21 CROSS-EXAMINATION

02:50:25PM 22 By Mr. Weaver:

02:50:28PM 23 Q. Mr. Hoory, could you briefly tell us what the
02:50:31PM 24 transfer pricing operations objectives were for the
02:50:34PM 25 Microsoft examination when you came into the picture in

02:50:36PM 1 late 2011?

02:50:37PM 2 A. It was really to take another look at the facts, to
02:50:41PM 3 consider the items like with the taxpayer Veritas, about
02:50:47PM 4 us being arbitrary and capricious, not addressing the
02:50:50PM 5 right facts, and to take a closer look at the residual
02:50:53PM 6 profit split model that Microsoft used in its valuation to
02:50:56PM 7 see whether if the inputs were reasonable or not, to see
02:50:59PM 8 if we could apply it in a more reasonable manner, and also
02:51:03PM 9 recognizing that there was an interaction between the
02:51:05PM 10 technology transfer price that was paid by the United
02:51:09PM 11 States to Puerto Rico and the buy-in that Puerto Rico paid
02:51:13PM 12 to the United States. We wanted to test the transfer
02:51:16PM 13 price as well.

02:51:17PM 14 So regardless of our methodology for the outbound
02:51:20PM 15 transfer of intangibles, we knew it was impacted by the
02:51:23PM 16 transfer price on the inbound sale of the technology IP by
02:51:27PM 17 Puerto Rico. We knew that the RPSM model impacted the
02:51:31PM 18 transfer price on the inbound sale by Puerto Rico of
02:51:55PM 19 technology in the United States, and whatever that
02:51:56PM 20 transfer price, also would impact the value it was before
02:52:00PM 21 this transaction, or that is set, when the U.S. sold it to
02:52:05PM 22 Puerto Rico. So we knew the two were related. We needed
02:52:08PM 23 to test the methodology.

02:52:09PM 24 Q. Did you at the outset, when you became involved, seek
02:52:13PM 25 to resolve issues where possible?

02:52:16PM 1 **A. At the outset we certainly raised questions we had,**
02:52:20PM 2 **and we let the company know on the front end that we**
02:52:23PM 3 **always were working towards engaging with them to see if**
02:52:26PM 4 **there was room for resolution, and that we wanted to talk**
02:52:29PM 5 **to them before developing a final number, when the ink was**
02:52:33PM 6 **still wet, was the term that Mr. Maruca used.**

02:52:37PM 7 **Q. Let's turn to Exhibit 16, Page 1, please. Do you**
02:52:42PM 8 **recognize Exhibit 16?**

02:52:43PM 9 **A. I do.**

02:52:45PM 10 **Q. And what is it?**

02:52:46PM 11 **A. It is the cover letter for the protest that Microsoft**
02:52:49PM 12 **filed on January 29th (sic).**

02:52:51PM 13 **MR. WEAVER: Your Honor, I would move the protest,**
02:52:53PM 14 **Exhibit 16, into evidence.**

02:52:55PM 15 **MS. EAKES: Your Honor, Microsoft does object to**
02:52:58PM 16 **that. This is a document that we have been trying to**
02:53:00PM 17 **resolve issues with respect to redactions. We would**
02:53:04PM 18 **object to the wholesale admission of it because of the**
02:53:07PM 19 **remaining issuing unresolved. With respect to No. 16, it**
02:53:10PM 20 **is my understanding that Mr. Weaver agreed we can take**
02:53:11PM 21 **that up at a later point. So we would object to its**
02:53:14PM 22 **admission now. We don't object to the reference to this**
02:53:17PM 23 **particular page.**

02:53:18PM 24 **MR. WEAVER: Your Honor, what I would propose, and**
02:53:20PM 25 **I talked with Mr. Beck about this before I got up here, is**

02:53:22PM 1 that we move it into evidence. I am only going to refer
02:53:26PM 2 to three or four pages. This is a long document. And
02:53:28PM 3 that after the document is in evidence, and I want it to
02:53:33PM 4 be in the record, there are four numbers in this document
02:53:36PM 5 that we have agreed to redactions on. Otherwise, you see
02:53:39PM 6 a ton of redactions that we have agreed to, Microsoft
02:53:41PM 7 wanted to make. And if the court will allow us, before we
02:53:45PM 8 make the exhibits public, we will agree to the remaining
02:53:48PM 9 four redactions.

02:53:49PM 10 THE COURT: All right. With that understanding,
02:53:51PM 11 we will go ahead and admit 16, Madam Clerk.

02:53:57PM 12 (Exhibit No. 16 was admitted.)

02:53:57PM 13 By Mr. Weaver:

02:53:57PM 14 Q. Mr. Hoory, let's turn to the part of the protest
02:54:00PM 15 addressing the Americas transaction, page 37 of Part 3,
02:54:05PM 16 please. What you will see referred to here is a reference
02:54:14PM 17 to Veritas in the protest. Do you recall that Mr. Hoory?

02:54:18PM 18 A. I do.

02:54:18PM 19 Q. How did this reference -- and if we were to look
02:54:22PM 20 through pages a repeated reference -- to Veritas impact
02:54:24PM 21 the way that the exam was going to be conducted going
02:54:27PM 22 forward?

02:54:27PM 23 A. We basically are responding to the concerns I
02:54:31PM 24 discussed with Veritas earlier. We knew we needed to
02:54:35PM 25 really kick the tires, make sure we developed the facts

02:54:37PM 1 and circumstances correctly, and respond to some of the
02:54:40PM 2 allegations here about the IRS being arbitrary and
02:54:43PM 3 capricious. We also knew that we needed to actually look
02:54:46PM 4 at the inputs into the residual profit split model that
02:54:50PM 5 Microsoft had used, and to test them fully.

02:54:52PM 6 Q. Let's turn to Page 61 of Part 3, please. Look at the
02:55:03PM 7 heading here, "The Service's buy-in determination is
02:55:06PM 8 arbitrary, capricious and unreasonable." Did the
02:55:14PM 9 characterization of the audit work as arbitrary and
10 capricious have an impact on how the audit was going to
02:55:17PM 11 proceed?

02:55:18PM 12 A. It certainly did. It meant we really had to look at
02:55:20PM 13 the facts and circumstances and bring in the expertise we
02:55:23PM 14 needed, in this case, software industry expertise.
02:55:26PM 15 Because prior to this, just like we did in Veritas, all we
02:55:30PM 16 had was an economist, with no industry experts.

02:55:33PM 17 Q. Now, let's turn to Page 45. And if you could blow up
02:55:39PM 18 Footnote 90, please. I will start reading from here. "As
02:55:49PM 19 support, the Service cites internal memoranda summarizing
02:55:53PM 20 non-transcribed interviews of Microsoft employees from the
02:55:56PM 21 2000 to 2003 audit and resulting MITRE expert report
02:56:02PM 22 opining that software had perpetual useful lives if
02:56:07PM 23 'maintenance' R&D were performed. Such evidence is of
02:56:11PM 24 question utility," et cetera. Mr. Hoory, did this have
02:56:14PM 25 any impact on how you wanted to proceed?

02:56:16PM 1 **A.** Certainly. We knew that if we did have to rely on
02:56:19PM 2 statements by Microsoft, that we would have to get them on
02:56:21PM 3 the record if they were important or material, and if they
02:56:25PM 4 were in areas that we were unable to resolve issues with
02:56:28PM 5 the company.

02:56:28PM 6 **Q.** Now, let's turn to Page 18 of this part of the
02:56:31PM 7 protest, and look at the top part of the page, please.
02:56:37PM 8 Let's blow up that top paragraph. It talks about taxpayer
02:56:43PM 9 engaging KPMG to value certain things with respect to the
02:56:49PM 10 buy-in license. And then if you go on down, it also
02:56:52PM 11 refers to KPMG determining a transfer price. What was
02:56:59PM 12 your understanding when you read this early in the audit,
02:57:04PM 13 when you were involved, 2011/2012, of the role that KPMG
02:57:08PM 14 was playing in this audit?

02:57:10PM 15 **A.** My understanding was that KPMG was responsible for
02:57:13PM 16 preparing the valuation that Microsoft relied on to set
02:57:16PM 17 the arm's length price for both the outbound sale of
02:57:20PM 18 technology rights to Puerto Rico, and then for the inbound
02:57:23PM 19 sale of technology IP to the United States.

02:57:25PM 20 **Q.** Now, let's digress very briefly. If you can put
02:57:29PM 21 Exhibit 18 up, please? Mr. Hoory, I am referring you to
02:57:40PM 22 Exhibit 18. Do you recognize the numbers on this diagram?

02:57:42PM 23 **A.** I do. They are my understanding of KPMG's valuation,
02:57:47PM 24 the numbers they arrived at.

02:57:48PM 25 **Q.** And you pulled these numbers from where?

02:57:49PM 1 **A.** I pulled them from the KPMG model, including their
02:57:54PM 2 structured rate analysis.

02:57:55PM 3 **Q.** And were these numbers, with one correction, in your
02:57:58PM 4 declaration?

02:57:59PM 5 **A.** There was. In my declaration I had transposed the
02:58:02PM 6 15.56 billion for the technology license at the top and
02:58:08PM 7 the 15.35 billion for the R&D funding.

02:58:11PM 8 **Q.** Recognizing that our time is limited, could you tell
02:58:14PM 9 me --

02:58:15PM 10 Well, first, I will move this into evidence, your
02:58:18PM 11 Honors, as a demonstrative.

02:58:21PM 12 MR. BECK: Well, your Honor, demonstratives don't
02:58:22PM 13 get received in evidence, they are just demonstratives.

02:58:26PM 14 THE COURT: That's fine.

02:58:29PM 15 By Mr. Weaver:

02:58:29PM 16 **Q.** Let's take a look at the bottom gray part. Can you
02:58:31PM 17 explain the flow of what is going on here in terms of what
02:58:35PM 18 is represented?

02:58:35PM 19 **A.** Sure. So on the left you have Microsoft Corporation,
02:58:38PM 20 that is the U.S. parent and its U.S. affiliates. In the
02:58:42PM 21 bottom, the oval, you have the third parties. That's
02:58:44PM 22 where they collect the money from. So these are people
02:58:47PM 23 that are not related to Microsoft, other large
02:58:50PM 24 corporations and entities, some resellers, some
02:58:52PM 25 redistributors. The only person or the only entities that

02:58:55PM 1 have these third-party contracts, that enter into
02:58:57PM 2 contracts with these third parties, it is Microsoft U.S.
02:59:01PM 3 Before and after this transaction, those third-party
02:59:03PM 4 relationships collecting the money, is through the United
02:59:06PM 5 States affiliates, not Puerto Rico.

02:59:08PM 6 Q. Very briefly, can you describe the green arrows going
02:59:13PM 7 to and from Microsoft U.S. and Microsoft Puerto Rico?

02:59:16PM 8 A. Sure. So in the green you have a technology license
02:59:19PM 9 from the United States of software code rights to
02:59:22PM 10 Puerto Rico. Puerto Rico agrees to pay the United States
02:59:26PM 11 15.56 billion, not immediately, but in the future, as a
02:59:30PM 12 percentage of future sales. In the red, in the middle,
02:59:33PM 13 you have Puerto Rico agreeing to pay the R&D associated
02:59:37PM 14 with software code thereafter. Over the next ten years
02:59:41PM 15 they are expected to pay 15.35 billion. So those
02:59:45PM 16 numbers -- they are both what they expected to pay the
02:59:47PM 17 U.S. and what they expect in the next ten years.

02:59:50PM 18 Q. This is what KPMG projected in its model?

02:59:54PM 19 A. Yes, it is the numbers they based their valuation on.

02:59:57PM 20 Q. What are the blue lines at the bottom there?

02:59:59PM 21 A. The bottom in blue you have -- Remember, Microsoft
03:00:04PM 22 U.S., they are the ones that are selling everything to
03:00:06PM 23 third parties. They are the only ones with the
03:00:09PM 24 third-party licenses and royalties. So the United States
03:00:11PM 25 agrees to remit to Puerto Rico a percentage of every

03:00:15PM 1 dollar they collect, about 55¢ on the dollar, roughly.

03:00:20PM 2 And they are basically paying Puerto Rico as the treater

03:00:22PM 3 (sic) of the software code that Puerto Rico just bought.

03:00:25PM 4 So it is a roundtrip. You have Puerto Rico buying

03:00:28PM 5 software code rights, agreeing to pay for R&D, it adds up

03:00:32PM 6 to about 30 billion. And over the next ten years -- And

03:00:35PM 7 that is over ten years, too. And then over the next ten

03:00:38PM 8 years the U.S. plans to turn around and pay Puerto Rico

03:00:41PM 9 about 67.8 billion for the software code that Puerto Rico

03:00:45PM 10 is treated as owning. The net impact of all this is, over

03:00:48PM 11 ten years, Microsoft expected to report \$38 billion less

03:00:54PM 12 in taxable income in the United States. Instead, that

03:00:57PM 13 income would be sitting in Puerto Rico where it is not

03:00:59PM 14 taxed, at least for domestic tax purposes.

03:01:02PM 15 Q. Now, with the aid of this diagram can you very

03:01:05PM 16 succinctly describe for the court the primary area of

03:01:07PM 17 information that you are still seeking in this audit to

03:01:11PM 18 get to the right number?

03:01:12PM 19 A. So we are looking for the revenue, and information

03:01:15PM 20 about the revenue and expense it puts on this, and the

03:01:17PM 21 split between technology intangibles as the software code

03:01:21PM 22 on the one hand, and non-technology intangibles on the

03:01:25PM 23 other. So we are talking about the customer

03:01:26PM 24 relationships, the trademarks. The United States has all

03:01:28PM 25 the non-technology intangibles after this deal, and

03:01:32PM 1 Puerto Rico has purchased the software codes. So you need
03:01:34PM 2 to know what the relative amounts are. That impacts --
03:01:36PM 3 Q. Why do you need to know the relative amounts?
03:01:38PM 4 A. You need to know the relative amounts because
03:01:41PM 5 Puerto Rico is paying the United States for the value of
03:01:43PM 6 the software code they purchased. Obviously, depending on
03:01:47PM 7 how important software code is to their business, it could
03:01:50PM 8 be worth more or less than the buy-in. It is also
03:01:53PM 9 critically important in the bottom under the technology
03:01:55PM 10 transfer price --
03:01:56PM 11 Q. You are talking about the 67 billion transfer price?
03:01:59PM 12 A. I am. That 68 billion, that is supposed to be
03:02:02PM 13 reflective of how valuable the software code is to the
03:02:05PM 14 business. If marketing intangibles, if customer
03:02:09PM 15 relationships, if all these things that Microsoft does,
03:02:12PM 16 the corporation in the United States, are more important,
03:02:15PM 17 then that 67.8 billion should go down. So we are looking
03:02:19PM 18 at the inputs, revenues, and expenses that KPMG used to
03:02:23PM 19 model this and the assumptions they made.
03:02:26PM 20 Q. Back to 2012. During the first part of 2012, did you
03:02:29PM 21 hire a number of industry experts to take a look at this
03:02:32PM 22 transaction?
03:02:32PM 23 A. We did. For the first time we brought on a number of
03:02:35PM 24 software industry experts, a marketing expert, and a
03:02:39PM 25 finance expert. Previously all we had was an economist.

03:02:42PM 1 We also had an outside economist expert as well to help us
03:02:45PM 2 with this, look at KPMG's process.

03:02:48PM 3 Q. Now, we are not going to look at it in any detail,
03:02:51PM 4 but was there another transfer pricing arrangement that
03:02:53PM 5 you were also looking at?

03:02:55PM 6 A. There was. They had a deal in the Asia Pacific
03:02:58PM 7 region. A difference between the Asia Pacific region and
03:03:01PM 8 the United States is the U.S. is a roundtrip. They sell
03:03:04PM 9 something out of the U.S. and immediately they buy it back
03:03:06PM 10 for more. In Asia Pacific they sold everything to their
03:03:09PM 11 foreign affiliate. However, the split between technology
03:03:13PM 12 and non-technology is still at issue there because of some
03:03:17PM 13 positions that Microsoft took. Basically we need to know
03:03:20PM 14 what the split is there as well, because they took the
03:03:22PM 15 position, which we don't necessarily agree with, that all
03:03:27PM 16 of the -- in fact, I believe, 95 percent of non-technology
03:03:30PM 17 was owned by their foreign affiliate. So they didn't have
03:03:34PM 18 to pay for that. We don't think the foreign affiliate
03:03:37PM 19 owned that much, and we also are also questioning the
03:03:40PM 20 split there as well.

03:03:41PM 21 Q. Now, in early 2012, did TPO withdraw the notice of
03:03:45PM 22 proposed adjustments?

03:03:46PM 23 A. We did.

03:03:46PM 24 Q. Did you tell Microsoft, of course?

03:03:48PM 25 A. We did before doing so, and at the time we did.

03:03:52PM 1 Q. And did Microsoft agree to further extensions of the
03:03:55PM 2 statute?

03:03:55PM 3 A. They did agree to extend the statute.

03:03:57PM 4 Q. All right. Let's turn very briefly to Exhibit 15.

03:04:04PM 5 Do you recognize Exhibit 15?

03:04:05PM 6 A. Yes. It is a Duff & Phelps report prepared for
03:04:09PM 7 Microsoft.

03:04:09PM 8 Q. Did you get it as part of the audit?

03:04:11PM 9 A. We got it after we reopened the audit, effectively.

03:04:15PM 10 It was a December IDR, December of 2012. It is one of the
03:04:18PM 11 first questions we asked them when we started to look at
03:04:21PM 12 the facts and circumstances more closely.

03:04:23PM 13 Q. Did you get the backup for it?

03:04:25PM 14 A. Not initially. We asked for all documents, and we
03:04:29PM 15 wound up having to issue a follow-up IDR, because all we
03:04:33PM 16 got was the report, none of the cross-referenced
03:04:35PM 17 attachments.

03:04:35PM 18 Q. So they didn't give you all you needed the first
03:04:37PM 19 time?

03:04:37PM 20 A. Not immediately. We eventually got it.

03:04:41PM 21 MR. WEAVER: I would move this Exhibit 15 into
03:04:43PM 22 evidence, your Honor.

03:04:45PM 23 MR. BECK: Your Honor, here our objection is not
03:04:49PM 24 as to specific redactions, it really goes to what
03:04:52PM 25 Ms. Eakes addressed in her opening statement. This has

03:04:58PM 1 nothing to do with the issue before the court, which is
03:05:04PM 2 was Quinn Emanuel -- should these summonses be enforced,
03:05:09PM 3 and can Quinn Emanuel take sworn testimony. This is in
03:05:12PM 4 fact exactly what the IRS warned would happen if somebody
03:05:17PM 5 dared to oppose them, that they would make a big showing
03:05:23PM 6 and introduce evidence that has nothing to do with the
03:05:27PM 7 subject matter of the hearing, but is calculated to
03:05:30PM 8 inflame by painting us in a bad light. So that is our
03:05:35PM 9 objection, your Honor.

03:05:36PM 10 THE COURT: Mr. Weaver, how is this relevant?

03:05:39PM 11 MR. WEAVER: This is relevant, your Honor, because
03:05:41PM 12 all morning we heard about how Quinn Emanuel has only been
03:05:45PM 13 hired to prepare this case for tax court. I am leading up
03:05:47PM 14 to how we still need information, with this foundation.
03:05:51PM 15 This is a foundation.

03:05:53PM 16 I am also going to get to in a minute things that have
03:05:55PM 17 come in through the summonses that weren't disclosed to
03:05:58PM 18 the IRS before. It just goes to the point that this case
03:06:02PM 19 is not being prepared -- the summonses are not to prepare
03:06:05PM 20 the case for tax court, we need legitimate information.
03:06:09PM 21 And I want to build that record.

03:06:11PM 22 MR. BECK: Your Honor, this is dated 2006, is it?
03:06:19PM 23 And he said -- The last question was, we did get the
03:06:22PM 24 information -- we didn't get it all exactly when we wanted
03:06:25PM 25 it, but then we got it. And Quinn Emanuel didn't come

03:06:31PM 1 along until May of 2014. And there is no linkage
03:06:37PM 2 whatsoever between the contents of this document and the
03:06:43PM 3 circumstances of the Quinn Emanuel hiring. It is truly
03:06:51PM 4 what was warned about in our opening statement.

03:06:54PM 5 MR. WEAVER: Your Honor, I am laying the
03:06:55PM 6 foundation as to why the IRS needed assistance in this
03:06:59PM 7 audit. There are major things that were suspicious. I am
03:07:03PM 8 about to lay a foundation of why the summonses are
03:07:06PM 9 perfectly legitimate, and why the issuance of those
03:07:08PM 10 summonses had nothing to do with the retention of Quinn
03:07:12PM 11 Emanuel or the regulation.

03:07:13PM 12 THE COURT: All right. The objection will be
03:07:15PM 13 overruled. 15 will be admitted, Madam Clerk.

03:07:20PM 14 (Exhibit No. 15 was admitted.)

03:07:20PM 15 By Mr. Weaver:

03:07:21PM 16 Q. Mr. Hoory, I would now turn your attention very
03:07:23PM 17 briefly to Page 14. Mr. Hoory, there is a number of
03:07:32PM 18 \$30 billion at the bottom there. Can you explain to me
03:07:35PM 19 how this impacted on the audit and your need for
03:07:39PM 20 expertise?

03:07:39PM 21 A. Sure. So this says 30 billion for MACSH, that is
03:07:46PM 22 MOPRs, Puerto Rico's parent. When we look at the backup
03:07:51PM 23 for this, it was prepared using the exact same profit and
03:07:55PM 24 loss forecast that KPMG relied on. This was for tax
03:07:58PM 25 purposes. It used the exact same information, which was

03:08:01PM 1 **effective as of July 1st, because that's what the P&L**
03:08:04PM 2 **started with, July 1, 2005, notwithstanding this was a few**
03:08:06PM 3 **months later. So this was based on a forecast, the same**
03:08:18PM 4 **forecast KPMG used for the July 1st, 2005 effective**
03:08:33PM 5 **valuation. The \$30 billion here is based on the same**
03:08:36PM 6 **information KPMG used, the same forecast. And it**
03:08:39PM 7 **basically says that when Duff & Phelps looked at this and**
03:08:44PM 8 **asked what the right value was for this for a tax**
03:08:46PM 9 **transaction that occurred nine months later, they said it**
03:08:50PM 10 **was \$30 billion. Because that information was the same**
03:08:53PM 11 **information KPMG relied on as of July 1st, 2005, they are**
03:08:58PM 12 **effectively saying a company that was worth nothing or a**
03:09:02PM 13 **nominal amount on June 30th, 2005, was worth 30 billion**
03:09:06PM 14 **one day later.**

03:09:07PM 15 **Q. And did you want to pursue this through additional**
03:09:11PM 16 **expertise?**

03:09:12PM 17 **A. We did.**

03:09:12PM 18 **Q. Let's move on to Exhibit 41. Mr. Hoory, a few**
03:09:28PM 19 **minutes ago you described your knowledge about KPMG as**
03:09:32PM 20 **having done valuation work in connection with the Americas**
03:09:36PM 21 **transaction. Did there come a time when your view of**
03:09:42PM 22 **KPMG's role in this transaction that is under audit**
03:09:46PM 23 **changed?**

03:09:46PM 24 **A. Yes. Through the summonses that were issued to KPMG,**
03:09:51PM 25 **and one of the IDRs to Microsoft in the fall of 2014, we**

03:09:58PM 1 learned that KPMG had also helped them -- at least
03:10:01PM 2 provided input on structuring the transaction.

03:10:04PM 3 Q. And you learned this information essentially within
03:10:08PM 4 the last year, even though the audit has been going on for
03:10:12PM 5 a number of years?

03:10:13PM 6 A. Correct.

03:10:13PM 7 Q. So we are on Exhibit 41. And I will just highlight
03:10:22PM 8 this. We can blow it up. Quote, "New company won't even
03:10:27PM 9 have a chart of accounts for probably 18 months. Shadow
03:10:30PM 10 books necessary." Did that catch your eye when you read
03:10:34PM 11 this document recently?

03:10:35PM 12 A. It did. It seemed to reflect concerns that the
03:10:37PM 13 Puerto Rican entity that was immediately worth \$30 billion
03:10:41PM 14 one day later, that when they set this up, it wasn't going
03:10:43PM 15 to be doing much more for 18 months, and didn't have any
03:10:46PM 16 accounts.

03:10:46PM 17 Q. Let's turn to Page 2. Blow that paragraph up. "What
03:10:58PM 18 can we do to make this thing real? Notify third parties,
03:11:01PM 19 at a minimum." It goes on about maybe entering into some
03:11:05PM 20 sort of insurance. What did this mean to you when you
03:11:07PM 21 read it?

03:11:08PM 22 A. It basically confirmed the bells that had been
03:11:10PM 23 ringing for us, Puerto Rico doesn't have third-party
03:11:14PM 24 contacts, it doesn't make sales, and here they are looking
03:11:18PM 25 at ways they could make -- to make this deal look like it

03:11:21PM 1 is a real business deal as opposed to something that they
03:11:24PM 2 just did for tax purposes.

03:11:25PM 3 Q. Let's go back out and go to the top of the first page
03:11:29PM 4 of this exhibit, please. The first page. This appears to
03:11:33PM 5 be a Microsoft preplanning meeting, March 31, 2005. Do
03:11:37PM 6 you recognize the folks listed at the top there?

03:11:39PM 7 A. I do. They look like the persons from KPMG that were
03:11:43PM 8 performing the valuation for Microsoft.

03:11:45PM 9 Q. And this came in through the summons that -- one of
03:11:48PM 10 the summonses at issue, or the one that preceded that; is
03:11:51PM 11 that correct?

03:11:51PM 12 A. It was. I think we received this, actually, this
03:11:54PM 13 year, from KPMG.

03:11:56PM 14 MR. WEAVER: I would move Exhibit 41 into
03:11:58PM 15 evidence.

03:11:58PM 16 MR. BECK: The same objection, your Honor. There
03:12:00PM 17 has been no linkage whatsoever. It is a mudslinging
03:12:03PM 18 campaign, and it is objectionable.

03:12:08PM 19 THE COURT: Thank you. That will be overruled.
03:12:10PM 20 41 will be admitted.

03:12:12PM 21 (Exhibit No. 41 was admitted.)

03:12:12PM 22 By Mr. Weaver:

03:12:13PM 23 Q. One more, Exhibit 40. Let's turn to Exhibit 40,
03:12:17PM 24 please. Do you recognize Exhibit 40, Mr. Hoory?

03:12:21PM 25 A. I do. It is the second set of notes. This one has

03:12:25PM 1 attendees from Microsoft, as well as KPMG.

03:12:29PM 2 Q. The attendees from Microsoft, are they Microsoft tax
03:12:33PM 3 department folk?

03:12:34PM 4 A. Yes, including David Guenther and Glen Cogswell, two
03:12:38PM 5 of the persons identified at Microsoft as having
03:12:41PM 6 participated in structuring this deal.

03:12:43PM 7 Q. I want to refer you to Page 2 of this document,
03:12:48PM 8 please.

03:12:48PM 9 MR. BECK: Your Honor, before we go on, could I
03:12:51PM 10 just make a foundational objection? I would at least like
03:12:54PM 11 to know when they first received this document.

03:12:57PM 12 THE COURT: Can you answer that, Mr. Hoory?

03:13:00PM 13 By Mr. Weaver:

03:13:00PM 14 Q. Mr. Hoory, do you know when you received this
03:13:02PM 15 document?

03:13:02PM 16 A. This was received in response to the KPMG summons
03:13:06PM 17 that we issued. We had a September summons, and then
03:13:09PM 18 repeated in November. I don't know exactly when this
03:13:15PM 19 Bates number was received. It would have been sometime in
03:13:18PM 20 the fall of 2014, or early -- I'm sorry, fall of 2014 or
03:13:22PM 21 early 2015.

03:13:24PM 22 MR. BECK: That is sufficient for my purposes,
03:13:25PM 23 your Honor. I object. He promised that all of this had
03:13:29PM 24 to do with why they needed to hire Quinn Emanuel. Quinn
03:13:33PM 25 Emanuel was hired long before they even get this document.

03:13:37PM 1 MR. WEAVER: What I said, your Honor, was this has
03:13:39PM 2 to do with the purpose for the summons. It has nothing to
03:13:43PM 3 do with trying to get the tax work.

03:13:45PM 4 THE COURT: All right.

03:13:46PM 5 By Mr. Weaver:

03:13:47PM 6 Q. If we could blow up the paragraph that has to do with
03:13:49PM 7 May '99. Mr. Hoory, can you explain what this paragraph
03:13:59PM 8 means to you?

03:14:00PM 9 A. So here they are talking about technology intangibles
03:14:04PM 10 versus non-technology, which they refer to as marketing
03:14:07PM 11 splits.

03:14:07PM 12 MR. BECK: Your Honor, I have a slightly different
03:14:10PM 13 objection. That is, he now says it has to do with why we
03:14:15PM 14 issued the summons. They got the document after they
03:14:18PM 15 issued the summons. This document came in after Quinn
03:14:24PM 16 Emanuel is hired, after the summons was already issued.
03:14:27PM 17 But they think it makes us look bad. It has nothing to do
03:14:32PM 18 with either of those issues.

03:14:34PM 19 MR. WEAVER: Your Honor, it does --

03:14:34PM 20 THE COURT: It hasn't been moved into evidence
03:14:37PM 21 yet, counsel. Let Mr. Weaver lay his foundation for his
03:14:40PM 22 questions. If he moves it into evidence, then we can
03:14:44PM 23 discuss it at that point in time.

03:14:45PM 24 MR. WEAVER: Thank you, your Honor.

03:14:47PM 25 By Mr. Weaver:

03:14:47PM 1 Q. Mr. Hoory, what was your understanding when you
03:14:49PM 2 received this document, about this paragraph?
03:14:50PM 3 A. So my understanding was that the persons at this
03:14:54PM 4 meeting were concerned because they had different splits
03:14:58PM 5 between technology and non-technology in the prior cost
03:15:02PM 6 sharing arrangements that they performed for Europe, the
03:15:05PM 7 Middle East, and Africa, two of those, and the one in
03:15:08PM 8 Asia, versus what they were looking to do in the Americas.
03:15:12PM 9 There were inconsistencies in their technology and
03:15:14PM 10 non-technology splits, the same split that we wanted
03:15:18PM 11 information to more reliably determine.
03:15:20PM 12 Q. What is the split that you understand KPMG to have
03:15:24PM 13 used in the Americas transaction?
03:15:25PM 14 A. So in the Americas transaction, if you look at the
03:15:28PM 15 entire timeframe, it is approximately 78 percent towards
03:15:32PM 16 technology, and, using the terminology the taxpayer used
03:15:35PM 17 here, about 22 percent towards marketing.
03:15:38PM 18 Q. And is that inconsistent with what you are looking at
03:15:41PM 19 here in this 2005 meeting document?
03:15:44PM 20 A. It is. Here they have much more -- at least some of
03:15:47PM 21 them are much more favorable towards non-technology, for
03:15:52PM 22 instance, 55 percent tech versus 45 non-tech.
03:15:57PM 23 Q. Is trying to get down to the bottom of how much to
03:16:00PM 24 allocate to technology versus non-technology at the core
03:16:04PM 25 of most of the pending summonses requests --

03:16:07PM 1 **A. Absolutely. It is central to the outbound sale of**
03:16:10PM 2 **software code, and to the inbound payments from -- I'm**
03:16:16PM 3 **sorry, not inbound. The outbound sale and inbound**
03:16:20PM 4 **payments by Puerto Rico, and then the transfer price that**
03:16:23PM 5 **the United States pays Puerto Rico, that 68 billion. If**
03:16:27PM 6 **technology is too high, the U.S. is paying Puerto Rico too**
03:16:31PM 7 **much, and there is too little income reported in the**
03:16:33PM 8 **United States.**

03:16:34PM 9 **MR. WEAVER: Your Honor, I will move on. First,**
03:16:36PM 10 **let me move for this exhibit's admission into the record.**

03:16:39PM 11 **MR. BECK: We object, your Honor. Quinn Emanuel**
03:16:42PM 12 **was hired in May of 2014, the designated summons issued, I**
03:16:52PM 13 **believe, October 30, 2014. This witness said that this**
03:16:59PM 14 **document was received in November or December. That's**
03:17:02PM 15 **after Quinn Emanuel is hired. It had nothing to do with**
03:17:05PM 16 **that. It was after the designated summons issued. It had**
03:17:11PM 17 **nothing to do with that. It is totally irrelevant, and it**
03:17:16PM 18 **is part of what looks pretty clearly like a calculated**
03:17:19PM 19 **effort to disclose confidential information they think**
03:17:24PM 20 **will make us look bad in retaliation for us daring to**
03:17:28PM 21 **oppose the IRS.**

03:17:30PM 22 **MR. WEAVER: Your Honor, if I may? We agreed to**
03:17:33PM 23 **the redactions Microsoft wanted to make in this exhibit.**
03:17:37PM 24 **What this goes to is, we are trying to get this same kind**
03:17:41PM 25 **of information through all of the summons requests that**

03:17:45PM 1 have to do with the Americas transaction. And there are
03:17:48PM 2 things that are just now coming out in 2014 and 2015 that
03:17:52PM 3 completely justify why the requests are pending. That's
03:17:55PM 4 what this goes to.

03:17:56PM 5 THE COURT: All right. 41 will be admitted.

03:18:00PM 6 (Exhibit No. 41 was admitted.)

03:18:00PM 7 By Mr. Weaver:

03:18:01PM 8 Q. Mr. Hoory, let me take you back in time now. You
03:18:05PM 9 went through three timelines earlier today. So can you
03:18:10PM 10 very briefly just tell me why, if you started getting
03:18:17PM 11 experts in 2012, it took all the way until, let's say, the
03:18:23PM 12 fall of 2013 before you were even thinking about being
03:18:27PM 13 ready to talk with Microsoft in that third timeline?

03:18:31PM 14 A. So we needed to learn enough to raise intelligent
03:18:35PM 15 questions and see what we agreed with them on and what we
03:18:39PM 16 didn't. We needed to have our industry expertise, that
03:18:42PM 17 is, our software industry experts, and our financial
03:18:44PM 18 experts, and in particular our software code expert,
03:18:47PM 19 complete their analysis so that they could provide that to
03:18:49PM 20 our economist, and our economist in turn can do the
03:18:53PM 21 modeling, because each of these people play a different
03:18:56PM 22 role, and the economist's work depends on those other
03:18:58PM 23 experts.

03:18:58PM 24 In particular, with respect to the software code
03:19:00PM 25 expert, it took a while for that to be completed. For

03:19:05PM 1 about the first six months or so we were getting new
03:19:08PM 2 reports, new reports that we had not previously gotten
03:19:11PM 3 from the company, on their internal code churn or code
03:19:16PM 4 reuse analyses. So our experts had to talk to the person
03:19:19PM 5 who authored those reports, ask questions, make sure we
03:19:23PM 6 understood them.

03:19:24PM 7 By November of 2012, so about six months in, our
03:19:27PM 8 experts knew enough to begin to request what source code
03:19:30PM 9 they wanted to look at to measure reuse. So code reuse
03:19:35PM 10 was something that KPMG cited in their evaluation as one
03:19:39PM 11 of their rationales for their short useful life there,
03:19:43PM 12 which impacts the valuation. Our expert needed to look at
03:19:46PM 13 software code.

03:19:47PM 14 And then from November, for several months, there were
03:19:50PM 15 delays where we went back and forth with the company about
03:19:52PM 16 where and under what conditions our software code experts
03:19:56PM 17 would be allowed to look at the software code. Eventually
03:19:59PM 18 those were resolved. Our expert was not able to complete
03:20:01PM 19 their analysis until the end of August in 2013.

03:20:05PM 20 Q. Let me stop you there. The software code expert,
03:20:08PM 21 upon which other experts were going to use as input, was
03:20:13PM 22 done in the fall of 2013?

03:20:15PM 23 A. Yeah. They completed looking at the code in, I
03:20:17PM 24 think, August, and then they had to have some time to
03:20:20PM 25 prepare their analysis so we could give it to the

03:20:22PM 1 **economist.**

03:20:22PM 2 **Q. Now, was it your intention to try to then present the**
03:20:26PM 3 **findings of these experts to Microsoft to resolve issues,**
03:20:29PM 4 **or at least narrow them?**

03:20:30PM 5 **A. Absolutely. That was the meeting that is reflected**
03:20:33PM 6 **on all of the timelines.**

03:20:34PM 7 **Q. And because I am not sure it is in the record yet,**
03:20:37PM 8 **did you also want to retain an outside commercial**
03:20:39PM 9 **litigator to help evaluate the case before you made that**
03:20:43PM 10 **presentation?**

03:20:43PM 11 **A. That was the initial attempt for Boies Schiller. By**
03:20:48PM 12 **the time we got looking at Quinn Emanuel, that was**
03:20:52PM 13 **impractical. Initially we wanted that input before we**
03:20:54PM 14 **went to Microsoft so that we could have an independent**
03:20:57PM 15 **analysis and gut check.**

03:21:00PM 16 **Q. And can you recall when the Boies Schiller contract**
03:21:05PM 17 **that never got worked on was entered into, roughly?**

03:21:08PM 18 **A. I think it was awarded sometime towards the end of**
03:21:13PM 19 **fiscal year 2011.**

03:21:15PM 20 **Q. You mean 2013?**

03:21:17PM 21 **A. Yes. I'm sorry, 2013. I don't remember the exact**
03:21:20PM 22 **month. On or about like June 2013, thereabouts.**

03:21:23PM 23 **Q. Well, for non-governmental people, end of fiscal**
03:21:28PM 24 **year --**

03:21:28PM 25 **A. September. The end of the fiscal year is September.**

03:21:31PM 1 So sometime between June and September that contract was
03:21:33PM 2 awarded.

03:21:34PM 3 Q. And just in a sentence or two, why was no work done
03:21:40PM 4 on that contract?

03:21:40PM 5 A. No work was done because we were unable to clear a
03:21:43PM 6 conflicts of interest issue.

03:21:45PM 7 Q. Now, did -- after the government shutdown that you
03:21:49PM 8 mentioned earlier today, did you in fact meet with
03:21:52PM 9 Microsoft and try to resolve outstanding issues?

03:21:55PM 10 A. We did. We met with them, presented our preliminary
03:21:58PM 11 analysis for them on January 14th, and suggested a number
03:22:01PM 12 of areas where we had open questions, and thought we
03:22:04PM 13 needed more information, and wanted to engage with them.

03:22:07PM 14 Q. If I could have Exhibit 14 up, please. Do you
03:22:18PM 15 recognize Exhibit 14?

03:22:19PM 16 A. I do. It is the presentation I delivered on
03:22:22PM 17 January 14th, 2014.

03:22:25PM 18 MS. EAKES: Your Honor, if I may. We do have
03:22:27PM 19 continuing issues with respect to 14, as well, as it
03:22:31PM 20 relates to redactions. So if Mr. Weaver is in agreement
03:22:35PM 21 with respect to 16 -- We would like to make sure that is
03:22:38PM 22 what the agreement is before they go into this document.

03:22:40PM 23 MR. WEAVER: Yes, your Honor. It is not my plan,
03:22:43PM 24 hopefully, to refer to the page that is not agreed.

03:22:46PM 25 THE COURT: All right.

03:22:47PM 1 **By Mr. Weaver:**

03:22:47PM 2 **Q.** Mr. Hoory, I think you said you did recognize this.

03:22:50PM 3 This was part of the presentation?

03:22:51PM 4 **A.** Absolutely.

03:22:52PM 5 **Q.** Let's turn to Page 22. So with the benefit of this
03:23:01PM 6 page, can you in very short order tell me where the areas
03:23:07PM 7 of discussion were with respect to revenues?

03:23:11PM 8 **A.** So on revenues -- These are financial inputs in the
03:23:14PM 9 valuation model. Microsoft assumed very low growth rates
03:23:18PM 10 for tax purposes, about four percent, for example, in
03:23:21PM 11 2006. In their SEC reporting they were saying ten to
03:23:25PM 12 twelve percent, approximately. That was a large
03:23:27PM 13 difference. Also, in this CAGR, or compounded annual
03:23:31PM 14 growth calculation error -- they had math errors.

03:23:35PM 15 **Q.** How much was the math error over time?

03:23:37PM 16 **A.** Over time it understated -- if you believe everything
03:23:40PM 17 else, it understated revenues by approximately
03:23:43PM 18 \$15 billion.

03:23:44PM 19 **Q.** Can you briefly tell me, very briefly, about where
03:23:51PM 20 the areas were for expenses that you wanted to discuss?

03:23:57PM 21 **A.** For expenses, we had to allocate worldwide expenses
03:24:00PM 22 to the region and to the retail channel, what was
03:24:03PM 23 applicable for this deal. We found some math errors
03:24:07PM 24 there, some distortions. There was also open questions
03:24:10PM 25 about how to identify geographic revenues and expenses

03:24:14PM 1 that we hoped to engage with them on.

03:24:16PM 2 Q. Last, what did you mean by writing, "Deal of the
03:24:20PM 3 century return on investment"?

03:24:23PM 4 A. This is what our financial expert who worked on Wall
03:24:26PM 5 Street said. He looked at the return that MOPR,
03:24:29PM 6 Puerto Rico that is, was expected, and it was over
03:24:33PM 7 200 percent per year. He said that's unheard of. Maybe
03:24:38PM 8 not for a start-up company, but certainly for an
03:24:41PM 9 established company with an established business as a new
03:24:43PM 10 investor.

03:24:47PM 11 Q. Now, during the meeting, who was there for Microsoft?

03:24:51PM 12 A. So they had, I believe, four attorneys from Baker
03:24:54PM 13 McKenzie, which was Jim O'Brien, Salim Rahim, Paul Schick,
03:25:01PM 14 and John Peterson. There was Bill Sample, and Mike
03:25:05PM 15 Bernard, as well as, I believe, Molly Vlahovich, and David
03:25:08PM 16 Guenther, and Tracy Neighbors from Microsoft.

03:25:11PM 17 Q. Who ended up asking most of the questions at your
03:25:14PM 18 resolution meeting?

03:25:15PM 19 A. Most of the questions were posed by Baker & McKenzie
03:25:19PM 20 attorneys.

03:25:19PM 21 Q. What happened after this meeting?

03:25:21PM 22 A. After this meeting, we initially broke (sic) with
03:25:23PM 23 them, shook hands. They said they had to think a little.
03:25:27PM 24 They promised us feedback within 30 to 60 days, at least
03:25:29PM 25 on the mechanical issues. Eventually, after going back

03:25:32PM 1 and forth a little, in mid to late February, Mr. Sample
03:25:36PM 2 said he wasn't sure that we could meet; he didn't think we
03:25:39PM 3 could do global resolution, but they were still committed
03:25:42PM 4 to giving us 60-day feedback. Through March, April and
03:25:46PM 5 May, it was sort of a hot/cold message from the company.
03:25:49PM 6 Sometimes it was, "We can't talk to you on anything." At
03:25:51PM 7 other times, "Oh, we will still talk to you on these
03:25:54PM 8 things." For example, in May we were still talking about
03:25:56PM 9 engaging on the revenue and expense systems that input the
03:26:02PM 10 dollars and cents for these valuation models. We shared
03:26:06PM 11 an outline with them. And they said, "We are still
03:26:10PM 12 looking at your stuff, we are still looking at the
03:26:12PM 13 materials you gave us in January, we need more time." I
03:26:15PM 14 told Mr. Bernard and Molly Vlahovich, "Well, we are going
03:26:20PM 15 to have to do interviews. We can't wait a couple more
03:26:22PM 16 months."
03:26:22PM 17 Q. When did you tell them they were going to have to do
03:26:26PM 18 interviews?
03:26:26PM 19 A. Repeatedly. This was specifically focused on May. I
03:26:29PM 20 believe it was the May 1st meeting where we talked about
03:26:32PM 21 that. The next week we issued IDRs actually seeking the
03:26:36PM 22 identity of the persons who were responsible for managing
03:26:39PM 23 their accounting systems, the accounting systems that were
03:26:41PM 24 used to input revenues and expenses. Because if we
03:26:46PM 25 couldn't talk to the tax department in a collaborative

03:26:49PM 1 manner, we needed to talk to the people who held the, I
03:26:52PM 2 guess, keys to the actual systems, the businesspeople.
03:26:54PM 3 Q. Now, let me just back up for a second. You testified
03:26:58PM 4 earlier today that you had an initial meeting with Quinn
03:27:02PM 5 Emanuel for the purposes of seeing if you wanted to retain
03:27:04PM 6 them; is that correct?
03:27:05PM 7 A. That's correct.
03:27:06PM 8 Q. From that point forward, all the way through July 15,
03:27:10PM 9 when you sent information to them, did you have any
03:27:12PM 10 substantive conversations or did you get any advice from
03:27:16PM 11 Quinn Emanuel?
03:27:16PM 12 A. No. The conversations were purely limited to
03:27:20PM 13 procedural issues, logistics, about the contracting
03:27:23PM 14 process.
03:27:24PM 15 Q. Now, I think it is in one of Microsoft's
03:27:28PM 16 declarations, they talk about your issuing five, quote,
03:27:32PM 17 wrap-up IDRs in the first few months of 2014. Did you
03:27:37PM 18 consider those to be wrap-up IDRs?
03:27:40PM 19 A. I considered them to be IDRs on open issues.
03:27:43PM 20 Q. And did there come a time when you thought that there
03:27:48PM 21 needed to be follow-up with additional IDRs?
03:27:51PM 22 A. Yes. Basically we focused initially -- I think only
03:27:56PM 23 four of those five were focused on pure transfer pricing
03:28:01PM 24 issues, one or two on Asia Pacific, and the other two were
03:28:04PM 25 seeking the identities of these people, these managers of

03:28:07PM 1 accounting systems, so we could talk to them. And then,
03:28:09PM 2 you know, in July, after Mr. Sample said, "We are not
03:28:13PM 3 going to talk to you on anything at all; just finish your
03:28:15PM 4 audit," then we went back and we issued -- well, actually
03:28:21PM 5 July -- before and after he said that, we were preparing
03:28:25PM 6 IDRs on all the topics that we thought were necessary to
03:28:28PM 7 get to the right split, to get to the right number between
03:28:32PM 8 technology and non-technology. And those were the July
03:28:35PM 9 IDRs.

03:28:35PM 10 Q. I want to focus on the July IDRs. Did you start
03:28:40PM 11 preparing those in May and June, before you had any
03:28:41PM 12 conversations with Quinn Emanuel?

03:28:42PM 13 A. Yes, before I had any substantive conversations with
03:28:44PM 14 Quinn Emanuel.

03:28:45PM 15 Q. Did Quinn Emanuel have any input whatsoever in the
03:28:48PM 16 July IDRs that were issued to Microsoft?

03:28:50PM 17 A. They had absolutely no input whatsoever on the July
03:28:54PM 18 11th IDRs or on the July 18th IDR.

03:28:57PM 19 Q. Did those IDRs essentially ask for some of the same
03:29:00PM 20 information that are being asked for in the pending
03:29:03PM 21 summonses?

03:29:04PM 22 A. They do. They are split up by subject matter. They
03:29:07PM 23 are on subject matters we thought would help us with the
03:29:09PM 24 revenue and expense inputs, or with subject areas that
03:29:14PM 25 would be potentially informative as to the split between

03:29:17PM 1 tech and non-tech.

03:29:18PM 2 Q. And did one of those IDRs ask questions about who
03:29:22PM 3 outside of Microsoft helped plan and draft the Americas
03:29:24PM 4 agreements?

03:29:25PM 5 A. It did. IDR IE-2209 asked about background
03:29:30PM 6 information about the Americas planning.

03:29:32PM 7 Q. And did you get a sufficient response prior to the
03:29:36PM 8 summonses?

03:29:36PM 9 A. We did not receive any documents in response to that
03:29:40PM 10 IDR until, I believe, October 2nd, although the cover
03:29:45PM 11 letter is dated September 30th. And we received
03:29:51PM 12 significant and material new information, that had not
03:29:54PM 13 been previously provided, in response to the summonses.
03:29:57PM 14 We are still seeking additional information.

03:29:59PM 15 Q. Now, the regulation has been referred to here today.
03:30:07PM 16 I just want to ask a follow-up question. You mentioned
03:30:10PM 17 something about Tom Ralph having handled another case that
03:30:17PM 18 you learned about in 2013. Did there come a time in 2014
03:30:22PM 19 when Mr. Ralph and you had some discussion about this
03:30:26PM 20 regulation?

03:30:27PM 21 A. There did. When the regulation was finally
03:30:31PM 22 promulgated and final, Tom took credit for it, and
03:30:35PM 23 jokingly referred to it as, "It shall be known in the
03:30:39PM 24 future as the Ralph Rule." That was the joke between
03:30:41PM 25 those of us in Transfer Pricing Operations.

03:30:44PM 1 Q. Let me turn to the designated summons very quickly.
03:30:59PM 2 That would be Exhibit 13. Do you recognize Exhibit 13?
03:31:08PM 3 A. I do. It is a designated summons issued on
03:31:12PM 4 October 30th.

03:31:13PM 5 MR. WEAVER: Your Honor, I would move that into
03:31:16PM 6 evidence.

03:31:18PM 7 THE COURT: Any objection to 13, counsel?

03:31:21PM 8 MR. BECK: No objection.

03:31:22PM 9 THE COURT: Thank you. Madam Clerk, 13 will be
03:31:25PM 10 admitted.

03:31:28PM 11 (Exhibit No. 13 was admitted.)

03:31:28PM 12 By Mr. Weaver:

03:31:29PM 13 Q. Let me refer you, if I could, Mr. Hoory, to several
03:31:33PM 14 of these requests, several pages in. I think they are on
03:31:36PM 15 Page 8. I will refer you to the requests 14 through 17.
03:31:46PM 16 Can you briefly summarize the kind of information that you
03:31:49PM 17 are seeking in the designated summons in 14 through 17?

03:31:53PM 18 A. So all of these requests focus on forecast or forward
03:31:57PM 19 looking expectations that the company had internally.
03:32:00PM 20 Some of them focus on forecasts or expectations that were
03:32:05PM 21 used for business planning. And 17 specifically focuses
03:32:08PM 22 on the forecasts that we were aware of, that the company
03:32:10PM 23 had previously given us, as having been prepared in
03:32:12PM 24 connection with their tax deal.

03:32:13PM 25 Q. Let's flip very quickly now to Exhibit 28. Do you

03:32:26PM 1 recognize Exhibit 28?

03:32:27PM 2 A. I do. It is an IDR issued back in 2008, seeking
03:32:31PM 3 forecast information relevant to the business groups in
03:32:35PM 4 the Americas that were the subject of the Americas
03:32:38PM 5 cost-sharing arrangement.

03:32:40PM 6 Q. And what is the response from Microsoft here?

03:32:43PM 7 A. The response refers back to an earlier IDR response.
03:32:48PM 8 Basically they are saying, "Go look at the forecast that
03:32:51PM 9 KPMG used," without providing any additional information.

03:32:52PM 10 MR. WEAVER: I would move this exhibit into
03:32:54PM 11 evidence, your Honor.

03:32:59PM 12 THE COURT: Any objection to 28?

03:33:02PM 13 By Mr. Weaver:

03:33:03PM 14 Q. Let's turn to Exhibit 29.

03:33:04PM 15 MR. BECK: No objection.

03:33:05PM 16 THE COURT: 28 will be admitted, Madam Clerk.
03:33:07PM 17 (Exhibit No. 28 was admitted.)

03:33:07PM 18 By Mr. Weaver:

03:33:07PM 19 Q. What is Exhibit 29?

03:33:08PM 20 A. This is a follow-up IDR that I was involved with in
03:33:11PM 21 2013. We were seeking information about the forecast that
03:33:19PM 22 they referred to. That is that 2026 IDR forecast. We
03:33:24PM 23 basically wanted to know, "Hey, did you look at anything
03:33:27PM 24 else for tax purposes? If so, give us a copy of it." And
03:33:30PM 25 we asked if they had any supporting documentation for that

03:33:33PM 1 **forecast to explain these low growth rates that they used.**

03:33:37PM 2 **We also asked who was responsible for preparing that**

03:33:39PM 3 **forecast for the tax-driven valuation.**

03:33:42PM 4 **Q. Let's flip to the third page. Did they identify**

03:33:50PM 5 **someone?**

03:33:50PM 6 **A. Yes, they basically said that Chris Suh, who was one**

03:33:54PM 7 **of the people we interviewed in October, prepared it at**

03:33:58PM 8 **the request of Glen Cogswell, who is also one of the**

03:34:01PM 9 **people we have issued a summons for, seeking testimony.**

03:34:04PM 10 **Q. Did they refer you to a particular document here?**

03:34:09PM 11 **A. They referred to the same document that was provided**

03:34:11PM 12 **in response to IDR IE-2026. That is the**

03:34:21PM 13 **2005_0926_MSFT_PL.xls. In response to our request for any**

03:34:25PM 14 **backup documentation describing anything -- any of the**

03:34:27PM 15 **assumptions therein, you know, detail on that forecast,**

03:34:30PM 16 **they say they couldn't find anything -- or that they would**

03:34:32PM 17 **look.**

03:34:32PM 18 **Q. Let's go to Exhibit --**

03:34:35PM 19 **MR. WEAVER: I would move that exhibit into**

03:34:37PM 20 **evidence, your Honor, 29.**

03:34:39PM 21 **MR. BECK: No objection.**

03:34:40PM 22 **THE COURT: Madam Clerk, 29 is admitted.**

03:34:43PM 23 **(Exhibit No. 29 was admitted.)**

03:34:43PM 24 **By Mr. Weaver:**

03:34:44PM 25 **Q. Exhibit 30, please. What is Exhibit 30?**

03:34:52PM 1 **A. Exhibit 30 was issued at the same time as the**
03:34:54PM 2 **previous one.**

03:34:55PM 3 **Q. What does it ask for?**

03:34:56PM 4 **A. It asks for a forecast, except this time we are**
03:34:59PM 5 **focusing on business forecasts, the same thing they used**
03:35:02PM 6 **for their business planning, as well as any tax forecast**
03:35:05PM 7 **that they prepared, other than the one relied on by KPMG.**

03:35:08PM 8 **Q. And what is the response?**

03:35:10PM 9 **A. They say they couldn't find a single forecast of the**
03:35:13PM 10 **type we described prepared during the entire calendar year**
03:35:17PM 11 **of 2005.**

03:35:18PM 12 **Q. All right. Let's move to Exhibit 8.**

03:35:22PM 13 **MR. WEAVER: First, I would move Exhibit 30 into**
03:35:25PM 14 **evidence.**

03:35:25PM 15 **MR. BECK: No objection.**

03:35:26PM 16 **THE COURT: 30 will be admitted.**

03:35:28PM 17 **(Exhibit No. 30 was admitted.)**

03:35:28PM 18 **By Mr. Weaver:**

03:35:29PM 19 **Q. Let's go to Exhibit 8. What is Exhibit 8?**

03:35:31PM 20 **A. Exhibit 8 is the interview transcript for our**
03:35:33PM 21 **interview of Chris Suh, the same person who was identified**
03:35:37PM 22 **as having prepared the forecast at the behest of the tax**
03:35:41PM 23 **department. So he is an internal person at Microsoft in**
03:35:44PM 24 **their -- I think it is their financial planning**
03:35:46PM 25 **department.**

03:35:46PM 1 Q. And who led that interview?

03:35:50PM 2 A. I did.

03:35:50PM 3 Q. And let's turn to Page 99. Can you tell me what is

03:36:01PM 4 going on in this part of the interview, please?

03:36:02PM 5 A. In Lines 5 through 7, and clarified in 10 through 12,

03:36:06PM 6 I am saying, "Hey, has anyone asked you or contacted you

03:36:10PM 7 with respect to this tax project that you did for Glen

03:36:13PM 8 Cogswell, the project that he did to prepare forecasts

03:36:16PM 9 that KPMG could use?" And he says, "No, no one has

03:36:20PM 10 contacted me within the last six months."

03:36:24PM 11 Q. And did you follow up through a summons request for

03:36:27PM 12 this information, the summons request we just looked at a

03:36:30PM 13 few moments ago?

03:36:31PM 14 A. We did. 17 specifically focuses on the forecast that

03:36:36PM 15 Chris Suh prepared. He also says in here, not just the

03:36:39PM 16 last six months, but he can't recall any time in the last

03:36:42PM 17 several years, which would encompass those IDRs we looked

03:36:45PM 18 at, when someone at the tax department reached out to him

03:36:48PM 19 and said, "Hey, do you have any materials related to this

03:36:51PM 20 project?"

03:36:51PM 21 Q. Exhibit 31, please.

03:36:52PM 22 I am only going to refer to the first page here.

03:36:55PM 23 The same deal as the other two things that were not agreed

03:36:58PM 24 to?

03:36:58PM 25 MS. EAKES: You are only going to refer to the

03:37:01PM 1 first page of Page 31? You are not going to move for its
03:37:03PM 2 admission?

03:37:05PM 3 MR. WEAVER: I will move for its admission, but I
03:37:07PM 4 will agree --

03:37:08PM 5 MS. EAKES: To the other redactions --

03:37:09PM 6 MR. WEAVER: That you proposed.

03:37:09PM 7 THE COURT: Hang on. I want to make sure I
03:37:12PM 8 understand. This is the same as No. 16?

03:37:14PM 9 MR. WEAVER: Yes.

03:37:15PM 10 THE COURT: The parties have not fully agreed on
03:37:17PM 11 the redactions, but before it is released, it will be in
03:37:19PM 12 fact -- the agreement will be reached?

03:37:22PM 13 MR. WEAVER: Yes, your Honor, that is correct.

03:37:24PM 14 MR. BECK: We agreed to the first one based on the
03:37:29PM 15 representation that he agrees to the redactions that we
03:37:32PM 16 proposed that they had previously resisted.

03:37:35PM 17 MR. WEAVER: We are agreeing.

03:37:36PM 18 THE COURT: Thank you.

03:37:37PM 19 MR. BECK: So all of our proposed redactions that
03:37:40PM 20 are still in doubt get made?

03:37:42PM 21 MR. WEAVER: As of the last round, yes.

03:37:46PM 22 MR. BECK: Good.

03:37:47PM 23 THE COURT: All right.

03:37:50PM 24 MR. WEAVER: Before I forget, I would move the Suh
03:37:54PM 25 transcript, Exhibit 8, into evidence.

03:37:56PM 1 MR. BECK: We object to that, your Honor. We have
03:37:57PM 2 one page that may be relevant, but it is 100 pages or so
03:38:02PM 3 of a transcript. I can't sit here and tell you what's in
03:38:06PM 4 there and what is not in there. I don't think that
03:38:08PM 5 transcripts typically would get moved into evidence
03:38:11PM 6 anyway. But I don't think there is a need for an entire
03:38:14PM 7 transcript to come in when the subject matter was four or
03:38:19PM 8 five lines of testimony from a particular page.

03:38:22PM 9 MR. WEAVER: Your Honor, there is another reason
03:38:23PM 10 for that transcript going in. And if I have time, which I
03:38:27PM 11 may not, there are other transcripts in some of the
03:38:30PM 12 declarations submitted by Microsoft where they
03:38:33PM 13 cherry-picked a few pages in which John Gordon or another
03:38:37PM 14 Quinn Emanuel attorney asked some follow-up questions.
03:38:39PM 15 But if you look at the whole transcript, some of the
03:38:42PM 16 objecting attorneys for Microsoft are speaking more than
03:38:44PM 17 John Gordon spoke in those interviews. So I do want the
03:38:49PM 18 interviews in the record. And they have been redacted by
03:38:52PM 19 Microsoft. We have agreed to the redactions, to redact
03:38:56PM 20 confidential information. But it shows the volume of
03:38:59PM 21 questions that were asked by Quinn Emanuel as opposed to
03:39:03PM 22 the questions that were asked by IRS.

03:39:05PM 23 MR. BECK: So it is for an entirely different
03:39:07PM 24 purpose than what it was used for in court; we now find
03:39:10PM 25 why he introduces it. And, your Honor, the redactions

03:39:13PM 1 just have to do with information that is confidential
03:39:17PM 2 business information that shouldn't be aired in court. It
03:39:21PM 3 doesn't mean that unredacted material magically becomes
03:39:24PM 4 relevant. And so we've got a large transcript, and I
03:39:30PM 5 don't know all that is in it. If he wants to make a
03:39:33PM 6 rhetorical point about how many people made objections and
03:39:36PM 7 how many people said other things, he can do that in a
03:39:40PM 8 post-hearing submission. But I don't think that an entire
03:39:43PM 9 transcript ought to come into the public record based on
03:39:47PM 10 his representations.

03:39:48PM 11 THE COURT: That's my concern as well, Mr. Weaver.
03:39:51PM 12 I understand your point. I also know that you focused on
03:39:55PM 13 the initial page, and I understood Mr. Hoory's testimony,
03:40:00PM 14 so we are not going to admit anything.

03:40:02PM 15 MR. WEAVER: Fair enough, your Honor.

03:40:04PM 16 By Mr. Weaver:

03:40:05PM 17 Q. Let's move on to Exhibit 31. Mr. Hoory, Exhibit 31,
03:40:09PM 18 do you recognize this document?

03:40:10PM 19 A. I do. It is an email that was produced to us by
03:40:13PM 20 Microsoft, I believe at the end of December, but it has
03:40:17PM 21 Chris Suh on it, Fabien Mousseau. Fabien Mousseau, I
03:40:23PM 22 understand from our interview with Mr. Suh, is someone
03:40:24PM 23 that worked with him and helped him with the forecast and
03:40:27PM 24 the exercise with respect to the Americas.

03:40:28PM 25 Q. December of 2014?

03:40:29PM 1 **A.** That's when we received this. I think the 31st of
03:40:32PM 2 December, if I recall correctly.
03:40:33PM 3 **Q.** I am not going to turn to Page 2, but what did you
03:40:38PM 4 learn by receiving this that is relevant to your summons
03:40:41PM 5 requests?
03:40:42PM 6 **A.** Well, three things: First, there is a note that
03:40:46PM 7 refers to the forecasting exercise prepared for Glen
03:40:49PM 8 Cogswell. And it attaches a fairly robust PowerPoint
03:40:53PM 9 presentation showing a lot of the inputs and assumptions
03:40:56PM 10 that were used in that forecast. I think it is about 30
03:40:58PM 11 pages. So that is all the detail that we were seeking in
03:41:01PM 12 2184 that they said they couldn't find. And even though
03:41:04PM 13 Mr. Suh had this email, he didn't recall having been asked
03:41:08PM 14 for it under his transcript. And now we got it, but only
03:41:12PM 15 after we issued a summons.
03:41:13PM 16 Number two, there is a reference there to conservative
03:41:16PM 17 forecasts. And someone is dressing down another Microsoft
03:41:20PM 18 employee who assumed zero growth. And that is something
03:41:24PM 19 that Microsoft did in the Asia Pacific deal. We were also
03:41:27PM 20 trying to get forecast information. Here, I think it was
03:41:31PM 21 Fabien or Chris Suh, or one of their colleagues says,
03:41:35PM 22 "Zero growth isn't the conservative case, it is the
03:41:38PM 23 abysmal case," is what he says.
03:41:41PM 24 And then, finally, we see that there is actually three
03:41:43PM 25 types of forecasts that they performed: A conservative

03:41:45PM 1 **one, which is the lowest one that they performed. And**
03:41:48PM 2 **that's what they used in their tax valuation. There is an**
03:41:51PM 3 **intermediate one, which is supposed to track market**
03:41:54PM 4 **expectations. And then they have a BPR forecast, which is**
03:41:58PM 5 **the highest one. And that's expectations if they executes**
03:42:02PM 6 **all of their strategies successfully.**

03:42:03PM 7 **What we know from this is no growth is an abysmal**
03:42:07PM 8 **case, not a conservative case; that the conservative case,**
03:42:10PM 9 **which is something I tried to get information from Mr. Suh**
03:42:13PM 10 **on but he couldn't recall, is the lowest forecast. And**
03:42:15PM 11 **they actually had a lot of backup to the forecast exercise**
03:42:20PM 12 **they performed for the tax department, yet we didn't**
03:42:23PM 13 **receive it until after we issued a summons.**

03:42:24PM 14 **Q. And you had been asking for this information for**
03:42:26PM 15 **years?**

03:42:26PM 16 **A. Since 2008, effectively.**

03:42:28PM 17 **Q. Now, we are not going to look at all the exhibits. I**
03:42:32PM 18 **would like to, but can you tell me what you learned by**
03:42:34PM 19 **interviewing someone in the fall by the name of Bosco**
03:42:37PM 20 **Chau?**

03:42:38PM 21 **A. Mr. Chau was offered by Microsoft as someone who knew**
03:42:42PM 22 **about their business investment funds, or BIF, B-I-F,**
03:42:47PM 23 **program. And he characterized BIF investments as a sales**
03:42:51PM 24 **expense.**

03:42:51PM 25 **Previously in IDRs we had asked about why KPMG and**

03:42:55PM 1 Microsoft classified this BIF expense as routine, as
03:42:59PM 2 expenses that they did not treat as creating any
03:43:01PM 3 intangible value. Leaving those expenses and other costs
03:43:04PM 4 out of those that they would count towards non-technology
03:43:07PM 5 would have had the result of undervaluing the non-tech,
03:43:11PM 6 basically influencing that split. Microsoft's response to
03:43:16PM 7 our IDR said, "We treated those as routine, including
03:43:19PM 8 business investment funds expenses, as routine, because
03:43:22PM 9 they have no benefit beyond one year."

03:43:24PM 10 When we asked Mr. Chau about them, he said, "Actually,
03:43:27PM 11 BIF funds, they are used to recruit new clients, new
03:43:31PM 12 enterprise clients, clients that are relevant to the Asia
03:43:34PM 13 Pacific and the Americas transactions."

03:43:37PM 14 And when we asked him, "If you successfully deployed
03:43:42PM 15 BIF investments, these business investment fund -- proof
03:43:45PM 16 on concept investments, to get a new client, how long do
03:43:47PM 17 you expect them to last?" And his answer was, "Three
03:43:49PM 18 years, because they typically award three-year contracts
03:43:52PM 19 to enterprise partners." That belies the responses in the
03:43:56PM 20 IDRs that said business investment funds have no benefit
03:44:00PM 21 beyond one year.

03:44:00PM 22 Q. And do the summonses at issue seek more information
03:44:03PM 23 about those kinds of sales and marketing programs?

03:44:06PM 24 A. They do. They seek a wide variety of information
03:44:09PM 25 with respect to sales and marketing programs.

03:44:12PM 1 **Q.** What did you learn by interviewing somebody by the
03:44:15PM 2 name of Hanson?

03:44:15PM 3 **A.** Robert Hanson, as I recall, he was in charge of their
03:44:19PM 4 market research program. And he had identified three
03:44:21PM 5 classes of market research that he considered large or
03:44:25PM 6 high-profile annual or more often research. It was
03:44:29PM 7 basically customer satisfaction or CPE surveys, brand
03:44:35PM 8 tracking or image-tracking surveys, and then some
03:44:38PM 9 advertising research.

03:44:40PM 10 We had previously sought information about brands, I
03:44:44PM 11 believe it was in IDR IE-2145, initially. And we had a
03:44:50PM 12 follow-up to that because we saw some high-level brand
03:44:52PM 13 studies up through 2000, but none between 2000 and 2009.
03:44:56PM 14 So we asked for those in IDR IE-2168, if I recall
03:45:07PM 15 correctly.

03:45:10PM 16 The response we received from Microsoft was they
03:45:12PM 17 couldn't find them; they thought they were discontinued.
03:45:14PM 18 When we asked Mr. Hanson about them, he said that they
03:45:17PM 19 were performed annually. And we were asking about the
03:45:20PM 20 timeframe between 2000 and 2006. So he described those
03:45:24PM 21 brand -- high-level brand studies as the types of things
03:45:28PM 22 that he remembers being performed regularly, annually or
03:45:31PM 23 more often. Yet we didn't receive any after 2000.

03:45:35PM 24 **Q.** And the summonses are seeking that kind of
03:45:36PM 25 information?

03:45:37PM 1 A. We are seeking that, and we are also seeking the CPE,
03:45:40PM 2 customer and partner experience surveys, that Mr. Hanson
03:45:43PM 3 mentioned, and that several other persons mentioned as
03:45:46PM 4 having been used to evaluate persons' performance, whether
03:45:50PM 5 they were successfully deploying sales and marketing
03:45:54PM 6 functions on behalf of Microsoft.

03:45:57PM 7 Q. Without telling me any specific advice that you may
03:46:00PM 8 have received from Quinn Emanuel, how would you
03:46:03PM 9 characterize overall, at a high level, Quinn Emanuel's
03:46:07PM 10 impact on the designated summons?

03:46:09PM 11 A. Very, very limited.

Q. And let's turn to Exhibit 23. Do you recognize Exhibit 23?

03:46:22PM 14 A. T do.

03:46:23PM 15 Q. What is it?

03:46:26PM 16 A. It is the summons we issued to KPMG on November 17th
03:46:29PM 17 for information relating to their assistance with
03:46:33PM 18 Microsoft's Americas valuation plan.

03:46:37PM 19 Q. Did Quinn Emanuel have any impact on what was
03:46:40PM 20 requested here?

03:46:41PM 21 A. I don't recall them providing any input on this
03:46:43PM 22 summons

03:46:45PM 23 MR. WEAVER: I would move this into evidence, your Honor.

MR. BECK: No objection, your Honor.

03:46:48PM 1 THE COURT: Madam Clerk, 23 will be admitted.

03:46:51PM 2 (Exhibit No. 23 was admitted.)

03:46:51PM 3 By Mr. Weaver:

03:46:52PM 4 Q. Exhibit 22, please. What is Exhibit 22, Mr. Hoory?

03:46:58PM 5 A. A summons issued to E&Y, Ernst & Young, on

03:47:02PM 6 November 17th. It is focused on Ernst & Young's role with

03:47:05PM 7 respect to the Asia Pacific transaction.

03:47:07PM 8 Q. And do you recall Quinn Emanuel's input on this

03:47:10PM 9 summons?

03:47:10PM 10 A. Absolutely none whatsoever.

03:47:13PM 11 Q. Let's turn to Exhibit 21.

03:47:19PM 12 MR. WEAVER: I would move Exhibit 22 into

03:47:21PM 13 evidence.

03:47:21PM 14 THE COURT: Any objection to 22, Mr. Beck?

03:47:24PM 15 MR. BECK: No objection.

03:47:25PM 16 THE COURT: Thank you. 22 is admitted.

03:47:29PM 17 (Exhibit No. 22 was admitted.)

03:47:29PM 18 By Mr. Weaver:

03:47:30PM 19 Q. Exhibit 21, please. What is Exhibit 21?

03:47:35PM 20 A. A November 20th summons, a related summons. It is

03:47:38PM 21 following up on the designated summons issued to Microsoft

03:47:41PM 22 Corporation.

03:47:41PM 23 Q. And do you recall the input of Quinn Emanuel on this

03:47:44PM 24 document and the request therein?

03:47:47PM 25 A. I believe this primarily focused on the Asia Pacific

03:47:50PM 1 and some broad categories. And I do not believe Quinn
03:47:53PM 2 Emanuel had any input whatsoever on this summons.

03:47:56PM 3 MR. WEAVER: All right. I will offer this into
03:48:04PM 4 evidence as well.

03:48:04PM 5 MR. BECK: No objection.

03:48:05PM 6 THE COURT: Thank you, counsel. Exhibit 21 will
03:48:09PM 7 be admitted.

03:48:10PM 8 (Exhibit No. 21 was admitted.)

03:48:10PM 9 By Mr. Weaver:

03:48:10PM 10 Q. Exhibit 20, please. What is this?

03:48:15PM 11 A. This is a November 19th summons that we issued to
03:48:19PM 12 Microsoft, a related summons. Its subject matter focused
03:48:23PM 13 in large part on the Asia Pacific, but it had some cleanup
03:48:27PM 14 items with respect to the Americas as well.

03:48:30PM 15 Q. And without revealing any advice that you may have
03:48:34PM 16 received from Quinn Emanuel, did Quinn Emanuel have any
03:48:37PM 17 significant role in the questions asked in this summons?

03:48:40PM 18 A. No. The only input I recall getting from them were
03:48:44PM 19 the typo corrections on this one.

03:48:46PM 20 Q. Now, you have also issued summonses for interviews.
03:48:51PM 21 And I think eight are being enforced here through these
03:48:55PM 22 related actions. Generally, why are you seeking testimony
03:48:59PM 23 of these individuals?

03:49:00PM 24 A. So we are seeking testimony on the same subject areas
03:49:03PM 25 that were identified, effectively. We are seeking

03:49:07PM 1 information originally on -- in July. A number of those
03:49:11PM 2 persons we requested interviews in September and October,
03:49:14PM 3 but then weren't scheduled by Microsoft.

03:49:18PM 4 Q. And where did these names come from?

03:49:19PM 5 A. They came from two sources. They were either already
03:49:22PM 6 identified by Microsoft. And previously requested
03:49:27PM 7 examples of those would be James Allchin, Jeffrey Raikes,
03:49:31PM 8 Craig Mundie, David Guenther. We hadn't requested Glen
03:49:36PM 9 Cogswell, because we didn't then know how much he had to
03:49:39PM 10 do with the deal. After we saw some of the correspondence
03:49:43PM 11 that was produced in documents, probably in October, we
03:49:47PM 12 knew he had a much greater role. So then we asked for him
03:49:51PM 13 as well, another Microsoft employee.

03:49:54PM 14 The remainder were either mentioned in transcripts or
03:49:57PM 15 we already knew about them and confirmed -- that is, the
03:50:01PM 16 IRS already knew about them based on our pre-July
03:50:04PM 17 research, and we decided that we needed to cover some
03:50:07PM 18 topics that were not sufficiently addressed at the
03:50:10PM 19 September and October interviews.

03:50:13PM 20 Q. Earlier today you were accused of asking for this
03:50:18PM 21 information in these summonses to essentially prepare for
03:50:21PM 22 tax court litigation. Is that why these summonses were
03:50:24PM 23 prepared and the information sought?

03:50:27PM 24 A. No. We certainly know there is a possibility that
03:50:31PM 25 this will wind up in tax court. And, obviously, given the

03:50:34PM 1 state of the exam, that likelihood is obviously higher
03:50:37PM 2 than it might be in another case.

03:50:39PM 3 However, the summons is, just like in any examination,
03:50:42PM 4 they are supposed to help us get to the right number. And
03:50:44PM 5 regardless of the status of an examination, that is always
03:50:47PM 6 our goal at the IRS, and it is here as well, we want to
03:50:50PM 7 get to the right number, something that we can put on a
03:50:53PM 8 stat notice in this case, because we are obviously not
03:50:56PM 9 going the appeals route at this point. At least it
03:50:59PM 10 doesn't look like it is in the cards.

03:51:00PM 11 Q. Why is that?

03:51:01PM 12 A. It is because the number -- we think that the
03:51:04PM 13 valuation relied on by Microsoft was very weak. There is
03:51:08PM 14 no time left on the statute, so we are actually required
03:51:10PM 15 to issue a stat notice.

03:51:15PM 16 Let me be clear. This case has not been designated
03:51:18PM 17 for litigation yet. We are still seeking information to
03:51:20PM 18 get to the right number. But just from my own
03:51:23PM 19 perspective, we think that there are -- it is such a huge
03:51:31PM 20 divergence in numbers, we think it is a very aggressive --
03:51:37PM 21 this roundtrip, particularly in the Americas, the evidence
03:51:41PM 22 of KPMG and/or Microsoft potentially cherry-picking some
03:51:45PM 23 inputs. And we have put a lot of energy into it.

03:51:49PM 24 Just like I told Mr. Bernard leading up -- I think we
03:51:52PM 25 had this conversation in March. I said, "Given the size

03:51:55PM 1 here, we need to think long and hard, and designation is a
03:52:01PM 2 possibility." I think it continues to be, although that
03:52:04PM 3 is a future decision.

03:52:05PM 4 Q. Mr. Hoory, one last question. When you first started
03:52:10PM 5 seeking to retain Quinn Emanuel in late 2013, were you
03:52:13PM 6 committed to trying to resolve this case with Microsoft?

03:52:16PM 7 A. Absolutely. That was the whole point of meeting with
03:52:18PM 8 them on January 14th.

03:52:22PM 9 MR. WEAVER: Your Honor, at this point I don't
03:52:23PM 10 have any more questions, but I do want to now introduce
03:52:27PM 11 the administrative record into evidence, after Mr. Hoory
03:52:34PM 12 steps down.

03:52:42PM 13 THE COURT: All right. Anything else other than
03:52:44PM 14 the administrative record?

03:52:45PM 15 MR. WEAVER: No, your Honor. That is the balance
03:52:48PM 16 of our case. I did want to refer your Honor to a few
03:52:52PM 17 pages, though.

03:52:55PM 18 THE COURT: Please.

03:53:01PM 19 MR. WEAVER: Your Honor, I would refer you to
03:53:03PM 20 Exhibit 1, the first and second pages. This is a
03:53:18PM 21 certified administrative record. And I would offer it
03:53:20PM 22 into admission under Federal Rules of Evidence 803(8),
03:53:25PM 23 902(11).

03:53:34PM 24 THE COURT: All right. That will be admitted.
03:53:37PM 25 (Exhibit No. 1 was admitted.)

03:53:37PM 1 MR. WEAVER: Let me refer your Honor to a few
03:53:39PM 2 pages, just so they are in the record in case I don't get
03:53:42PM 3 to them with the limited amount of time we would have for
03:53:45PM 4 summations. Let me refer your Honor, maybe for later
03:53:51PM 5 reference in the record, to Page 126, part one. Can you
03:54:02PM 6 put that up on the screen, please? Page 126, please. The
03:54:22PM 7 reason I am going to refer you to that page is that, you
03:54:26PM 8 can see, is redacted. 6103. It is redacted because it
03:54:31PM 9 refers to another taxpayer there. We will be referring to
03:54:34PM 10 that either in closing summation or in further briefing as
03:54:38PM 11 evidence that this reg project did not start with
03:54:42PM 12 Microsoft.

03:54:44PM 13 Let me refer your Honor to a few other pages in the
03:54:47PM 14 few minutes I have left.

03:54:49PM 15 THE COURT: Hang on. Mr. Beck, do you want to
03:54:53PM 16 make a comment on that?

03:54:54PM 17 MR. BECK: Yes. This has nothing to do with the
03:54:56PM 18 examination of Mr. Hoory. Mr. Weaver just referred to,
03:55:05PM 19 "We can explain this in follow-on briefing." Given the
03:55:11PM 20 constraints we had today, in terms of timing, I don't
03:55:14PM 21 think that either one of us is going to have time to say,
03:55:17PM 22 "Here is the evidence that we couldn't present through
03:55:20PM 23 Mr. Hoory, but we, nevertheless, want your Honor to
03:55:22PM 24 consider." We certainly wouldn't have time to do that,
03:55:26PM 25 even if your Honor was going to entertain it.

03:55:29PM 1 What we would suggest, your Honor, and what we
03:55:32PM 2 contemplated was that we were going to be lucky if we were
03:55:35PM 3 to get done with Mr. Hoory today, but that the matter be
03:55:41PM 4 continued so that both parties can make written
03:55:43PM 5 submissions, where they submit the documents that they
03:55:47PM 6 believe the court should consider, as well as argument.
03:55:52PM 7 Your Honor indicated you didn't want to listen to me
03:55:57PM 8 present argument through Mr. Hoory.

03:55:59PM 9 That, or I suppose we could come back another day and
03:56:02PM 10 make our non-live testimony evidentiary presentations.
03:56:07PM 11 Although, I think both of us could probably do a better
03:56:09PM 12 job in writing than we would standing up here referring to
03:56:13PM 13 documents.

03:56:15PM 14 MR. WEAVER: Your Honor, if I may respond? My
03:56:18PM 15 intent here is to walk through this in five to ten
03:56:21PM 16 minutes, just so it is in the record. As far as we are
03:56:25PM 17 concerned, this should be it. Almost every single
03:56:29PM 18 innuendo and allegation that Microsoft made doesn't bear
03:56:32PM 19 out after you heard Mr. Hoory. So in terms of whether
03:56:37PM 20 they get discovery, I think that should be wrapped up.
03:56:41PM 21 But I agree on the issues of the reg, it is complicated,
03:56:46PM 22 and we are happy to have post-hearing briefing.

03:56:49PM 23 THE COURT: Counsel, I think that is the best way
03:56:51PM 24 of handling it. The administrative record is in the
03:56:54PM 25 record. It has been admitted, Mr. Weaver. It has been a

03:56:56PM 1 long day. Mr. Hoory talks a mile a minute, and it was
03:57:00PM 2 hard to follow up on all of that. Working for the IRS is
03:57:06PM 3 a good job for you. I think that Mr. Beck's suggestion
03:57:12PM 4 makes the most sense. It makes the most sense to me.

03:57:15PM 5 I may very well have some very specific questions for
03:57:18PM 6 both sides, in terms of what I want you to brief. So what
03:57:22PM 7 I propose is this: Let me think about what we heard today
03:57:26PM 8 in view of the material you have already submitted. Let
03:57:29PM 9 me see about what I want in terms of very specific
03:57:32PM 10 post-hearing briefing. We will notify the parties. Then
03:57:37PM 11 you can do the written submissions, respond to that, and
03:57:40PM 12 if the court feels it is necessary, we can bring you back
03:57:42PM 13 in and do oral argument as well. Does that make sense?

03:57:45PM 14 MR. WEAVER: Yes, your Honor.

03:57:47PM 15 MR. BECK: Yes. There are subjects that were just
03:57:50PM 16 inappropriate or ruled inappropriate to do with Mr. Hoory,
03:57:59PM 17 such as the circumstances surrounding the adoption of the
03:58:01PM 18 regulation. Whether you ask questions about that or not,
03:58:05PM 19 that is an important thing that we will want to explain,
03:58:07PM 20 the evidence that we do have on that and what the
03:58:09PM 21 implication of that is.

03:58:10PM 22 THE COURT: Absolutely. Some of those issues are
03:58:12PM 23 a matter of law. They have nothing to do with the facts
03:58:15PM 24 that were presented at the hearing today.

03:58:17PM 25 MR. WEAVER: Your Honor, if I could just clarify?

03:58:19PM 1 I am happy to brief, but I would ask that your Honor limit
03:58:22PM 2 the presentation of evidence to what got put in the record
03:58:25PM 3 today, so that the evidentiary hearing happens today, and
03:58:32PM 4 then we can brief the meaning of it --

03:58:32PM 5 MR. BECK: All we had time for today was one
03:58:34PM 6 witness. I had entire topics, such as all of the IRS
03:58:39PM 7 internal documents concerning the adoption of the
03:58:42PM 8 regulation. And this witness disclaimed any knowledge on
03:58:47PM 9 that. We are not able to present through this witness
03:58:54PM 10 documents that your Honor said he is not in a position to
03:58:59PM 11 testify about. So in order for us to make the evidentiary
03:59:02PM 12 showing on the other documents, we either have to do it in
03:59:06PM 13 writing, which I think makes the most sense, or we have to
03:59:09PM 14 come back another day and we can put on a document show.

03:59:12PM 15 MR. WEAVER: Your Honor, just let me respond to
03:59:15PM 16 that if I might. In terms of your order, if you go back
03:59:17PM 17 and look at the questions that deal with the regulation --
03:59:20PM 18 I think there were basically three. One was whether
03:59:23PM 19 notice and comment provisions had been complied with.
03:59:26PM 20 That is largely a legal issue. One was --

03:59:28PM 21 MR. BECK: Largely, but I've got a whole bunch of
03:59:32PM 22 exhibits, internal emails, that we want to present and
03:59:36PM 23 then argue from.

03:59:37PM 24 MR. WEAVER: Your Honor, that's what today was
03:59:39PM 25 about.

03:59:40PM 1 MR. BECK: Except I couldn't do it with the
03:59:42PM 2 witness.

03:59:42PM 3 THE COURT: Hang on a second.

03:59:45PM 4 MR. WEAVER: Second, there was an issue about
03:59:47PM 5 whether there was a reasoned analysis. Typically, your
03:59:49PM 6 Honor, unless there has been a showing -- a substantial
03:59:51PM 7 showing of bad faith, then you are supposed to decide
03:59:55PM 8 whether a reg is valid on the administrative record. And
03:59:58PM 9 in terms of whether there is a reasoned analysis, let's
04:00:02PM 10 argue that on the administrative record.

04:00:04PM 11 In terms of the timing of this reg, you heard from
04:00:07PM 12 Mr. Hoory. There is nothing but coincidence in terms of
04:00:10PM 13 the hiring of Quinn Emanuel and the reg.

04:00:13PM 14 THE COURT: Let me do this: Let me take some time
04:00:19PM 15 to absorb today in view of the documents already
04:00:24PM 16 presented, in view of the exhibits that I have not looked
04:00:28PM 17 at, and I will get back to you fairly quickly about
04:00:33PM 18 whether -- specifically what I want in terms of
04:00:36PM 19 post-hearing briefing. If the court feels there is
04:00:39PM 20 anything else that may be necessary, we will ask for that
04:00:43PM 21 as well. There are some issues that I believe are purely
04:00:49PM 22 matters of law. And that can be argued, as Mr. Beck
04:00:52PM 23 indicates, simply on the record that we already have. I
04:00:55PM 24 understand that not all of the testimony that Microsoft
04:01:00PM 25 may have wanted may have come in through this particular

04:01:02PM 1 **witness. We will see where we stand once I take a breath**
04:01:05PM 2 **and take a look at all of this.**

04:01:06PM 3 **All right? We are done today. Thank you all very**
04:01:12PM 4 **much.**

5 **(Proceedings adjourned.)**

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I, Barry Fanning, Official Court Reporter for the
United States District Court, Western District of
Washington, certify that the foregoing is a true and
correct transcript from the record of proceedings in the
above-entitled matter.

12 /s/ Barry Fanning
13 Barry Fanning, Court Reporter

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